REPORT OF
THE STUDY GROUP ON TERM LOAN PARTICIPATION ARRANGEMENTS

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RESERVE BANK OF INDIA

BOMBAY

1971

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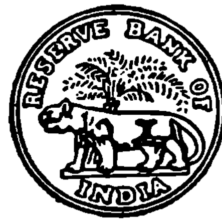

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INTRODUCTION

The Reserve Bank of India constituted in October 1970 a Study Group to report on Term Loan Participation Arrangements. The present Report submitted by the Study Group in March 1971 is being published with a view to stimulating the thinking on the subject and eliciting the views of the financial community as well as the general public on the various recommendations of the Group. The Study Group has noted that the creation of an active market in the instruments of term loans will have a number of advantages, but that there are also certain limitations in the existing arrangements which have to be overcome for the emergence of a market for the proposed instruments. The findings and recommendations of the Group are strictly those of its members. It is, however, hoped that a wider discussion following the publication of the Report will be of benefit to the Bank in arriving at decisions on the subject.

V. V. CHARI
Deputy Governor.

Reserve Bank of India,
Industrial Finance Department,
Central Office,
Bombay.

April 23, 1971.

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SECTION I

INTRODUCTION

Background

At the Fourteenth Conference of representatives of State Financial Corporations held in March 1970, Dr. R. K. Hazari, Deputy Governor of the Reserve Bank of India made a suggestion that co-ordination of the operations of various credit institutions providing industrial finance may be attempted through a system of bills or notes. Under this arrangement, it was suggested, the first credit institution to be approached by the borrower would receive the application for short and medium term credit, process it, appraise the project and provide financial assistance against promissory notes of different maturities executed by the borrower, which it may then sell to or discount with other credit institutions.

Membership and terms of reference

2. In consonance with one of the recommendations of this Conference, the Reserve Bank appointed in October 1970, the present Study Group to report on the administrative, legal, financial and other implications of this type of loan participation arrangement. The composition of the Group is as under :—

(1) Shri K. N. R. Ramanujam, *Chairman*
Chief Officer,
Industrial Finance Department,
Reserve Bank of India

(2) Dr. P. B. Medhora, — *Member*
Dy. General Manager,
Industrial Credit & Investment Corporation of India Ltd.

(3) Shri D. P. Sarin, — „
Dy. General Manager,
United Commercial Bank

(4) Shri Promodh Malhotra, — *Member*
Manager,
First National City Bank

(5) Shri N. H. Shah, — „
Managing Director,
Gujarat State Financial Corporation

(6) Shri A. Raman, — „
Director,
Credit Planning & Banking Development Cell,
Reserve Bank of India

(7) Shri N. V. Sundaram, — „
Dy. Legal Adviser,
Reserve Bank of India

(8) Shri V. S. Raghavan, — „
Manager,
Industrial Development Bank of India

(9) Shri Philip Thomas, — *Member—Secretary*
Deputy Chief Officer,
Industrial Finance Department,
Reserve Bank of India

The Study Group held in all four meetings, —on November 21, 1970, and on January 15, February 19 and March 5, 1971. The present Report was finalised at the last meeting.

The objectives of the Scheme

3. The creation of a market for term loans through their conversion into notes of appropriate maturities can be viewed as a further extension of the bill market for short term loans by commercial banks, recently introduced by the Reserve Bank. It may be recalled that the Reserve Bank had constituted in February 1970, a Study Group to go into questions covering the scope for enlarging the use of bill of exchange as an instrument of credit and the

creation of a genuine bill market in the country. The Study Group reported in June 1970 ; on the basis of its study and recommendations containing, *inter alia*, the advantages of a bill market to the Reserve Bank, commercial banks, other financing institutions and borrowers, the Bank introduced in the busy season which began in November 1970 a new Bill Market Scheme. In essence, the new Bill Market Scheme aims at replacing, to the extent possible, the prevalent system of overdraft and cash credit accounts which constitute about 70 per cent of the total financial accommodation to constituents by the scheduled commercial banks ; in the initial stages, it is intended that bank advances against book debts should be converted into bills. Ultimately, it also seeks to provide a mechanism, additional to the existing inter-bank Call Money Market, for an evening out of the liquidity pressures in the banking system.

4. The purpose of the present Study Group is to examine the scope for, and implications of the creation of a similar market for instruments of indebtedness covering medium and long term loans.

5. The objectives which a market for instruments of term loans could serve are as follows : Firstly, it would help to widen and develop the capital market by inducing a larger flow of savings to the financial institutions and to the industrial sector. Secondly, it would provide a mechanism for co-ordinating the activities of the different credit institutions. In fact, this alternative is preferable to any attempt at a demarcation of areas of operation between the banks on the one hand for dealing in short term debt and the term lending institutions on the other concerned with medium and long term debt; since the banks have the advantages of a wide branch-network, a close association with industrial units and a high rate of deposit mobilisation, it is assumed that banks will continue to be engaged in term lending, especially if the medium term credit needs of small industries spread throughout the country are to be fully met.

6. Thirdly, loan participation arrangements through marketable instruments of term loans could also serve to facilitate the flow of assistance for special purposes such as export credit. In this context, the suggestions on export credit contained in a recent note by Shri T. R. Varadachary, Chairman of the Export Credit and Guarantee Corporation and Managing Director of the State Bank of India, envisage participation by different financial institutions such as the Industrial Development Bank of India (IDBI), the commercial banks and the Life Insurance Corporation of India (LIC) in the granting of long term export credit through the instrument of promissory notes. We have set out in Annexure I, the relevant portions of Shri Varadachary's note which have a bearing on loan participation arrangements. As mentioned in the report, the increasing volume of export credit covering capital goods, turnkey projects, etc. and the relatively long periods for which export credit will have to be granted will make it difficult for commercial banks to handle this business by themselves. There are advantages in the IDBI or a specialised agency financing export credit in the form of buyer's credit and arranging for the participation of commercial banks and other financial institutions in such credit through promissory notes.

7. Finally, as in the case of the new Bill Market Scheme of the Reserve Bank of India, the creation of a market for instruments of term loans could conceivably help to absorb excess liquidity among financial institutions and reduce thereby their overall recourse to the Reserve Bank and the Industrial Development Bank. This, however, can be considered only as a distant objective, because as we discuss later, there is at present no such excess liquidity either among the financial institutions or the non-financial corporate sector in the economy, except of a purely short term nature. Such short term excess liquidity can be absorbed in short term bills and it may not be attracted to instruments of term loans. There is also no expectation of any significant change in the present position in this respect for at least the next few years.

8. As we discuss later, the two main instruments through which financial institutions can market their loans are : (*i*) usance promissory notes of the borrower and (*ii*) participation certificates. Brief descriptions of these instruments are set out in Annexure II.

SECTION II

THE PRESENT STRUCTURE OF THE MONEY AND CAPITAL MARKETS AND INTEREST RATES

The existing instruments of personal savings in the form of financial assets

9. As any scheme for loan participation through market instruments will be an innovation in the Indian capital market, it is necessary to consider how it will fit into the existing market and institutional arrangements. The first issue to be considered in this respect is the magnitude of personal savings and the forms of financial assets in which such savings are held at present. Personal savings as a percentage of national income has been relatively small and stagnant, the proportion of house-hold savings in the form of financial assets (Gross) to national income being only about 4.3 per cent to 4.8 per cent in recent years (Statement I). Financial savings of the house-hold sector in the form of investment in industrial securities has been equally negligible—being only around 5 per cent of the total between 1965-66 and 1968-69 (Statement I). As shown in the Statement, the principal financial assets of the house-hold sector at present are : bank deposits, currency, provident funds, life insurance contributions and claims on Government (representing mainly postal savings and other forms of small savings). Of these, provident fund and life insurance contributions are in the nature of contractual savings and are governed in the main by considerations such as tax benefits and cover against risks. The various forms of small savings are attractive partly because of tax concessions and partly because of the relatively higher rates of interest on them.

10. In so far as the savings of the public (including non-banking companies) in the form of financial assets are concerned, the new instruments will compete mainly with bank deposits and to some extent with certificates of the unit trust and deposits with non-banking companies. Unlike in many other countries commercial banks in India have been able to tap a relatively large volume of fixed deposits of comparatively long maturities (upto five years or over). As shown in Statement II, fixed deposits of scheduled commercial banks for periods over 3 years constitute nearly 30 per cent of the total fixed deposits. While institutional and other factors make international comparisons somewhat misleading unless account is also taken of the differences in the structure of the different economies, it is nevertheless relevant to note that in many countries with well-developed capital markets, commercial banks have traditionally not been attracting deposits with maturity periods exceeding two years. Another feature is that current deposits in many developed economies constituted a relatively larger proportion of total deposits than in India. Current deposits formed 50-55 per cent of total deposits in countries such as the U.K. and the U.S.A. as against 25 per cent in India—(*vide* Statement III).

11. The introduction of the new market instruments will imply that in order to maintain their volume of fixed deposits, banks will have to offer on term deposits, comparable rates of interest as on these instruments after allowing for the greater convenience, familiarity and liquidity which a bank deposit will have over the new instruments which would be an innovation and whose price, and, therefore, liquidity will depend on fluctuating market conditions. The commercial banks possess a large potential for the mobilisation of resources into the organised sector of the money and capital markets by making banking service itself more efficient, so that the public will rely more on cheques than on cash for effecting and receiving payments. It is only through enlarging considerably the banking habit of the community that they can maintain their position by stepping up the volume of demand deposits. Over a period of years, thus, the composition of bank deposits should tend to be such as in developed economies, that current deposits form a far larger proportion of the total than at present.

12. It must be noted that the main purpose of the new market instruments should be to induce a larger volume of savings in the economy and also to bring about a shift from

such forms of saving as investment in gold, jewellery or in real estate to investment in financial assets. The answer to the question as to how far the instruments will serve this purpose, and not merely bring about a shift from some forms of financial assets, say bank deposits or unit certificates, will depend on the degree of differentiation (such as in rates of returns, ease of conversion, etc.) of the new instruments from these alternative assets, and the appeal that the instruments can have to particular groups of investors. These factors can be determined only after the evolution of the market for the proposed instruments.

The implication of marketable instruments of term loans for the role of financial intermediaries

13. In considering the scope for the marketing of instruments of debt, a second feature of the present capital market to be taken into account is the large and growing reliance of industries on institutional finance. In the absence of a well developed capital market, industrial investment in our economy has been heavily dependent on financial assistance from the commercial banks and the specialised financial institutions. Firstly, although in recent years the base of the capital market has widened a good deal, yet it has not developed sufficiently to permit a number of medium sized enterprises from making issues of debentures, preference or equity shares ; many of them function as proprietary or partnership concerns or as private limited companies. Secondly, even in respect of old and well-established companies, the widening of the equity base and reliance on market borrowings have generally proved difficult. As shown in Statement IV, whereas in countries such as the U.K., the U.S.A. and Australia, internal sources and capital raised from the market formed between 68 per cent and 80 per cent of total funds raised by the corporate sector in 1968, in India the comparative figure was only 50 per cent. Again, whereas in those countries borrowings from financial institutions formed only 7.5 per cent to 20 per cent of total funds, in India these formed over 30 per cent. The dependence of the corporate sector in India on other sources of funds such as trade credit was also relatively high, forming nearly 20 per cent of the total, as against 9 per cent to 13 per cent in the U.K. and U.S.A. Again as shown in the Statement, the reliance of the Indian corporate sector on institutional finance expanded a good deal between 1960-61 and 1967-68 (the latest period for which the consolidated data are available).

14. While the pattern of financing of the Indian corporate sector and the trends therein reflect the institutional and other characteristics of the economy, to some extent, the relatively large reliance of corporate enterprises on institutional finance may also be attributed to the policy of direct financial support of the commercial banks to their established clients. This policy of scheduled commercial banks extending term loans to industries was in fact encouraged by the Reserve Bank of India in the sixties. However, recently, a change in emphasis has taken place in view of heavy demands made on the banking system for meeting the working capital requirements of the various sectors of the economy. In the context, especially of the acute financial stringency which the banking system passed through in the busy season of 1970-71, it seemed desirable that the big industrial borrowers were persuaded to have recourse to the market, when their profit record and general performance warranted this course, instead of relying on banks for term loan accommodation. The obligation placed on banks to extend their lending operations to priority as well as hitherto neglected sectors such as export, agriculture, small scale industries, small traders and other men of small means may be expected to reduce the relative flow of bank resources to other sectors and may require corporate enterprises to resort increasingly to the market for their capital requirements. Already, the pressure on the resources of banks seems to be bringing about a change in the traditional approach and the corporate sector appears to be having a greater recourse to the market in recent months. This trend may gather momentum in future.

15. The heavy and growing reliance of enterprises on borrowings from the financial institutions would not, by itself, have been a matter of concern if the institutions in turn had raised their resources largely from the pool of savings in the economy. However, as shown in Statements V, VI & VII most of the resources of the specialised institutions have been found by the Reserve Bank or the Government. The dependence of the institutions on these sources of finance is largely

a reflection, on the one hand, of the institutional set-up under which the bulk of the savings in the form of life insurance premia, provident fund contributions and small savings are channelised through the Government, and on the other, a relatively low level of savings. Given the fact that the bulk of personal savings in the form of financial assets are channelised through life insurance and provident funds and the fact that these funds in turn have to be invested largely in Government or Government-guaranteed obligations, it is inevitable that the Government has to be the main source of funds for the term lending institutions. At the same time, the ability of commercial banks to meet the growing demand for credit from the various sectors of the economy from out of their deposit resources is equally limited.

16. Against this background of the inability or reluctance of the industrial borrowers to turn to the market directly for their needs on the one hand, and the pressures on the resources of the lending institutions on the other, the new market instruments of term loans will enable the lending institutions to act as intermediaries for the placement of industrial loans and securities in the market. The instruments can potentially attract additional resources from the savings of the community and reduce to that extent the relative reliance of the lending institutions on the Government and the Reserve Bank, although on account of the institutional constraints mentioned above, such reduction in reliance on Government and Reserve Bank resources will be only marginal to begin with.

The problems of structure of interest rates and the yield on participation instruments

17. While considering the marketability of the term loan instruments, account will have to be taken of the relative yield these instruments can give as compared with the returns on alternative uses of funds. There are two main types of potential buyers of these instruments, namely, commercial banks and members of the public including business enterprises having liquid funds as well as savings institutions like UTI and LIC. For example, in the case of the International Finance Corporation (Washington) [IFC (W)], which has been successful in selling portions of its loans through the instrument of participation certificates, commercial banks are the main buyers of the certificates. The banks generally take up one to two year maturities of these certificates. One of the main attractions to commercial banks of IFC(W)'s participation certificates has been that the effective yield on the certificates is relatively higher than the long term lending rates of the banks. Under IFC(W)'s system of "strips" sales of loan and equity, the buyer gets portions of equity holdings along with the participation certificates.

18. In this context, we have to note a third feature of the Indian capital market, namely the existing structure of interest rates. In Statement VIII we set out the comparative short and long-term lending rates of commercial banks and specialised financial institutions in some foreign countries. It may be seen from the Statement that in these countries, the long-term lending rates are ½ per cent to nearly 2 per cent higher than the short-term lending rates charged by commercial banks. With an interest rate structure where the long-term rates are suitably higher than the short-term rates, it is possible for the term lending institutions to sell off portions of their loans to short-term lending institutions having surplus funds for investment. From this point of view, the existing structure of interest rates in India would seem to call for some review. The rates charged by the major commercial banks on their short-term advances vary between 9 per cent and 10½ per cent ; these are generally higher by 1 per cent to 1½ per cent than the standard rates on industrial loans of the term lending institutions. With this rate structure banks would not find it attractive to buy loan portions sold by the term lending institutions, except in periods when they may have surplus funds which they cannot use for short-term advances, or if the loan instruments are offered along with parcels of good equity, which banks may be able to take up on a selective basis and to limited extents.

19. As is well known, the pattern of interest rates is the result of a number of institutional and other factors. But it has been generally observed that under normal conditions the long-term rate would be higher than the short-term rate. It has also been observed that the long-term rate being more stable than the short-term one, instances where the short

term rate exceeds the long-term rate do occur when the short-term rate may have moved up sharply to meet a temporary situation of stringency. It can be conceded that for an under-developed economy, special concessional rates of interest may be needed to promote capital investment. But unless the concessional terms are offered on a selective basis, there is the likelihood that they may become self-defeating after a certain stage because they may have to be increasingly based on inflationary financing which might cause a misallocation of resources for investment. In Statements V, VI and VII are set out the extent of reliance of the term lending institutions in India on created funds. For IDBI, the entire resources are from the Government and the Reserve Bank representing only created money. Taking all the institutions, if the foreign exchange resources of the ICICI and IFCI made available by external agencies are excluded, the reliance of our term lending institutions as a whole on created money would be about 66 per cent. As pointed out in paragraph 15, institutional and other factors in the economy account for this reliance of the term lending institutions on the Government and monetary authorities for their resources. In the early stages of the evolution of term lending institutions while this source of financing may be unavoidable and desirable from the point of view of stimulating and ensuring a specific pattern of industrial investment, it is for consideration whether at the present stage this policy does not call for a fresh examination. The sources and pattern of financing of the term lending institutions can be altered and the institutions can derive a larger portion of their funds from the genuine savings in the economy if they establish links with the capital market. Such links can be forged only if they operate at market rates of return. The market rates would naturally vary from one investment to another depending on the magnitude of risk, the period of waiting involved, etc. But the specialised term lending institutions in India all of which have been deriving the bulk of their funds from the same source at fixed rates of interest have been generally making their funds available on the same terms to all their borrowers, without discriminating between projects involving greater risks etc. and others.

20. We must emphasise at this stage that what we envisage is not that the specialised financial institutions will derive the whole or even the bulk of their resources at market rates of interest or that they will charge correspondingly high rates on all their loans, but that they would derive at least a part of their resources at market rates and also correspondingly charge the market rates on a part of their transactions. Thus, to a large extent, because of the trustee status of their securities and owing to the institutional set-up mentioned above, under which Government mobilises a major portion of public savings at comparatively low rates of interest, the public sector financial institutions can continue to acquire funds below the market rate and based on this advantage they should be in a position to offer concessional terms to appropriate sectors, obtaining supplementary assistance where necessary from the Government or the monetary authorities. But, for their normal operations, they must progressively draw resources at market rates and should, therefore, aim at obtaining the market rates of return on their loans and investments (wherever warranted).

21. Further, what is to be aimed at by the term lending institutions is not so much the charging of a rate of interest on term loans higher than on short-term advances, but the realisation of a higher average yield on their funds comprising the interest on their loans and the return on their equity and other investments, insofar as the transactions are purely commercial. This would enable the institutions to market a part of their loans and investments and draw resources for fresh investments in promising lines. The role of a development finance institution should involve not merely the achievement of a satisfactory return on its funds, but a rapid turnover of its funds so that it can purposively direct the volume of industrial investment in the economy.

22. As regards the public, the main alternative financial assets to investment in term loan instruments will be, as indicated earlier, medium and long-term fixed deposits with commercial banks or with non-banking companies or certificates of the Unit Trust. The banks, for instance, currently accept long-

term deposits of 5 years and over, offering 7¼-7¾ per cent interest. Non-banking companies of good standing offer 8-8½ per cent interest on deposits over two years. In order to attract public savings into instruments of long-term debts, the yield on these will have, therefore, to be higher than 7¼-7¾ per cent, say around 8½-9 per cent. But, as discussed earlier, the structure of lending rates of term lending institutions is comparatively low and therefore, the yield on their loans will not be adequately attractive to ordinary investors. Moreover, as the main purpose of the introduction of these new instruments will be not the diversion of savings from the form of bank or company deposits or unit certificates, but the mobilisation of additional savings in the form of financial assets, the yield on these instruments must be relatively high while the instruments themselves need not be as liquid as deposits with a bank or a company. The yield on these instruments can be made attractive by the term lending institutions offering "strips" of portions of loans and good equity, so that the disadvantage of a moderate return by way of interest is made up by the prospects of capital appreciation on the equity. This would also help to differentiate the market for these instruments from that for the alternative financial assets. Where loans alone are marketed, the interest return would have to be pitched suitably high.

The narrowness of existing market and the need for a long-term perspective

23. Apart from commercial banks and the house-hold sector, the non-financial corporate sector could also be a potential source of investment in term loan instruments. In some countries such as the U.S.A., the corporate sector is in possession of liquid funds and is a major source of short-term investment funds; but in India this sector does not enjoy a similar degree of liquidity. This in turn could hypothetically be attributed to some extent to the more rapid rate of growth of investment of companies than the rate of their cash accruals, in the context of a developing economy. Partly, it may also be due to excessive investment in inventories.

24. Against the background of a banking sector the deposit growth of which has lagged behind the demand for credit emanating from the several sectors of the economy and the limited liquidity in the non-financial corporate sector, the market for term loan instruments is to be based ultimately largely on the mobilisation of additional savings of the house-hold sector to investment in financial assets. This, however, can come about only over a period of years and that too if there is in the Indian economy an environment conducive to the generation of voluntary savings. The perspective to be kept in view, while initiating any arrangements for the marketing of term loans is necessarily a long-term one, extending over the next ten years or so by which period some of the existing rigidities discussed earlier might have been overcome through appropriate policy changes.

SECTION III

TYPES OF PARTICIPATION ARRANGEMENTS

Administrative co-ordination and marketing of loans

25. The objective of loan participation between financial institutions can be achieved either through administrative co-ordination such as consortium arrangements and joint financing or through the lending institutions marketing portions of their loans to each other. In a logical sense, the two methods of participation are not mutually exclusive. There can be a marketing of loan portions subsequently even when there is administrative co-ordination at the beginning. But in a practical sense these can be looked upon as alternative arrangements for term loan participation between financial institutions. The method of participation through marketable instruments also offers the possibility of the general public participating in the loans, unlike in the case of consortium or joint financing arrangements which can be only between financial institutions.

Consortium or Joint Financing arrangements

26. Of the above two methods of participation, the first category, involving consortium or joint financing arrangements, would seem to be relatively simple and can be recommended for wider adoption by the term lending institutions on the one hand and the commercial banks on the other.

27. For relatively large loans/investments involving the all-India term finance institutions, namely the IDBI, the IFCI, the ICICI and the LIC, there are already certain well established joint financing arrangements. The main forum for co-ordinating the operations of these institutions in this respect is the monthly inter-institutional meeting of senior executives of these institutions, under the auspices of IDBI. In Annexure III we have set out certain operational arrangements for joint-financing which have been evolved by the all-India financial institutions. It is possible and necessary to have also similar arrangements for co-ordination of assistance between the all-India term lending institutions and the commercial banks.

28. In our view, the essential features of a scheme for such co-ordination should be (*i*) common appraisal; (*ii*) sharing of security; and (*iii*) common follow-up. Common appraisal will mean that the appraisal of one body, say the term lending institution will be acceptable to the other joint financier, say a commercial bank. The term lending institution while appraising the term loan applications would also take into account the requirements of working capital and would seek the advice of the commercial bank in assessing this requirement. It would also keep the commercial bank which is to give working capital to the assisted concern informed about its own appraisal of the loan proposal. This would help the bank to take into account the overall financial requirements and results of the assisted concern and thus systematise its appraisal of loan proposals for working capital. The bank may of course have its own independent appraisal of the project and not rely entirely on the term lending institution's appraisal. The sharing of information and procedures for common appraisal would make both the specialised institutions and the banks aware of each other's requirements and reduce to some extent duplication of work and the inconvenience to the entrepreneur in dealing with different credit institutions. In the matter of sharing of security, the arrangement would involve either creation of a *pari passu* charge on the assets of the borrowing concern in favour of the bank and the term lending institution concerned or the institution giving a second charge to the commercial bank on the assets mortgaged to it. A common follow-up may involve one participant acting as agent for other participants to collect the instalment payments and interest charges and mutual consultation when a rescheduling of the debt or calling up of loan or enforcement of securities is involved.

29. We set out in Annexure III three existing schemes, two for joint financing/co-ordination of loans to industrial concerns and one for joint financing of road transport operators, between State Financial Corporations and commercial banks. We recommend that wherever arrangements for joint financing/co-ordination of assistance have already been made, these should be strengthened and that the remaining SFCs and banks should also enter into similar arrangements.

Sharing of Credit Information

30. One aspect of joint financing is the sharing of credit information between the commercial banks and the term lending institutions. Joint appraisal and follow-up would entail the need for free sharing of information between the institutions. At present such sharing is restricted. In the absence of suitable legislation which would protect financial institutions giving the information from any action for damages by parties who may be adversely affected by the credit reports, the institutions have been reluctant to supply detailed information to each other. We recommend that the question of suitable legislation to offer the necessary protection to financial institutions must be urgently taken up.

Arrangements involving sales of loans

31. Participation arrangements falling under the second category mentioned above, namely those involving sales of portions of loans are of greater importance than those involving only administrative co-ordination because they would help to create a market for instruments of term loans and hence promote the development of the capital market.

Five Schemes for marketing of loans

32. We have set out in Annexure II brief descriptions of four existing schemes for loan participation through marketable instruments as well as the suggestion for a fifth scheme for sale of units in a balanced portfolio consisting of loans and equity investments. The four existing schemes are: (*a*) sale of promissory notes of the borrower either with or without recourse to the selling institutions, as in the case of the International Bank for Reconstruction and Development, (IBRD); (*b*) sale of participation certificates related to particular maturities of term loans as practised by IFC(W); (*c*) sale of participation certificates unrelated to particular instalments as in the case of participation certificates issued by some commercial banks in India; and (*d*) private placement of debentures.

33. A scheme for sale of units representing portions of a portfolio of loans and equity investments of a term lending institution, which would be analogous to units in a closed-end investment trust, could be a means for the lending institutions to derive funds from the market. However, as the discussion in Annexure II brings out, such a scheme has certain disadvantages as compared to the operations of a unit trust. Briefly, the main disadvantages are : (*a*) the portfolios which a term lending institution can offer may not be as broad-based and diversified as those of a unit trust or investment trust; (*b*) the returns on units offered by a term lending institution would ordinarily involve the incidence of double taxation unlike investments in certificates of unit trust as such trust in various countries, including the Unit Trust of India, enjoy tax exemption ; and (*c*) under the scheme there is no continuous re-investment and management of the original capital as in the case of an ordinary unit trust. Where a term lending institution or group of institutions have built up a sufficiently diversified and attractive portfolio and if there is provison for continuous management of the portfolio, there could, however, be advantages in operating a unit trust type of scheme based on such portfolios. It may be mentioned at this stage, that it is only the all-India term lending institutions which can contemplate a scheme of this type at the moment, since other term lending institutions like SFCs (with the exception of the Tamil Nadu Industrial Investment Corporation Ltd.) do not have any attractive equity holdings. The scheme may be operated by the lending institutions themselves or through a unit trust. In India, at present, only the UTI enjoys special tax concessions with regard to exemption from Corporation tax, inter-corporate dividend tax, etc. If any new scheme of this type is operated through the UTI, it would enjoy the same tax concession. Alternatively, there is scope for term lending institutions operating units schemes, or new investment trusts doing so provided they are extended tax concessions similar to those enjoyed by the UTI.

34. We do not favour a scheme of participation certificates unrelated to particular loan maturities, for the reasons mentioned in the Annexure. The main drawback of this scheme is that it approximates so closely to fixed deposits that it would result more in diversion of such deposits rather than the mobilisation of fresh savings. Secondly, the certificates do not necessarily relate to medium and long-term loans and the initial maturity of the certificates is also quite short varying from 30 days to 90 days.

35. The scheme of participation through privately placed debentures also has certain limitations which would restrict its use. Firstly, the administrative procedures involved in a debenture issue are somewhat more cumbersome than in a straight loan. Secondly, unlike promissory notes, transfers of which will involve no stamp duty, transfers of debentures involve stamp duty varying from Rs. 7.50 to Rs. 22.50 per Rs. 1,000 of the value of the debentures transferred, on each transfer. This would tend to limit the marketability of the debentures. Apart from the cost of marketing, the acceptability of unsecured debentures will also be less than that of a promissory note endorsed by a lending institution. As the debenture will not carry any such endorsement, its acceptability, particularly if it is an unsecured debenture, will depend entirely on the investor's confidence in the borrower issuing the debentures. Even if the debenture is a secured one, its acceptability and marketability will, other things remaining the same, be less than that of a promissory note arising from a secured loan and endorsed by a lending institution.

SECTION IV

RECOMMENDED SCHEME

Scheme based on promissory notes or participation certificates

36. In our view, a scheme for loan participation based on promissory notes of the borrower or one based on participation certicates similar to those issued by IFC(W) would seem to be the most advantageous. The choice between the instrument of promissory notes and participation certificates may be left to the financial institution concerned. Usance promissory notes of one year and over attract stamp duty of Rs. 6 per Rs. 1,000 which is levied by the Central Government and is uniform throughout the country. No further duty or transfer charges are payable on these notes. Participation certificates attract stamp duties levied by State Governments which vary from State to State. The lending institutions will have to decide in each case whether it is more advantageous to issue participation certificates or usance promissory notes taking into account the relative costs of stamp duty. If the funds are to flow to the capital market evenly and on a large scale in all States through the mechanism of participation certificates, it is necessary that the State Governments agree to levy a flat uniform low rate of stamp duty on participation certificates. If, however, some of the State Governments prefer to continue the present high rates of stamp duty, it is possible that the instruments may be issued or transferred outside their jurisdiction, in which event there will be a considerable loss of revenue to the State arising from this policy. In order to encourage the creation of marketable instruments of term loans in the form of promissory notes, we recommend that the Central Government should appropriately reduce the stamp duty on such notes created in favour of commercial banks and term lending institutions, through an administrative notification.

37. To ensure that the security available to the lending institution is also available to the transferee of the instrument, whether in the form of participation certificates or usance promissory notes, it is suggested that the security may be created in favour of the lending institution which will act as trustee for the issue. The usance promissory notes may be issued originally in favour of the lending institution which in turn will transfer them to others pursuant to an agreement to be excuted between it and the transferees. It will be specified in the instrument that it is issued pursuant to the agreement between the lending institution and the borrowers.

38. Since it will be administratively convenient if the original borrower is to deal with only the lending institution and not with the individual holders of the instruments, we recommend that all issues and transfers of promissory notes also may be registered with the selling institutions (as in the case of debentures and participation certificates) and that the selling institution in its capacity as trustee for the holders of the instrument may collect the amounts payable to them and make payments to them. In the event of default, recovery proceedings should be instituted by the selling institution on behalf of the holders. These conditions can be incorporated in the agreement between the selling institution and the purchaser and it can be specified on the instrument that it is transferred to the holder by the selling institution in pursuance of the said agreement.

39. As a lending institution may sell only portions of some of its loans, depending on its needs and other circumstances which may be judged only well after a loan has been disbursed, a question arises as to whether it should take promissory notes from the borrower for all the instalments for all its loans. If promissory notes are taken for the entire amount of each loan, there would be the incidence of some avoidable stamp duty and other costs. These costs can be obviated by the lending institution taking from the borrower at the time of each loan disbursement an undertaking to execute promissory notes for the outstanding balance of the loans and also an irrevocable power of attorney for the creation of promissory notes on his behalf, as and when the institution considers it necessary.

40. The minimum face value of a participation certificate or promissory note under the scheme may be, say, Rs. 5,000.

41. Exhibits I, II and III set out specimen forms, respectively, of (1) A promissory note relating to a term loan ; (2) Clauses in a Loan Agreement between the borrower and the lending institution agreeing to the creation of transferable usance promissory notes ; and (3) An Agreement between the lending institution and the purchaser of a promissory note.

42. The nature of participation certificates and the mechanics of their issue and operation are explained in Annexure II. As indicated in the Annexure, the buyer of a participation certificate gets only a beneficial interest in the amount transferred and has no direct access to the original borrower. The institution issuing the certificate also acts as the agent for the buyer to collect the instalments and interest amounts due. Exhibits IV, V and VI give specimen forms, respectively, of (1) A clause in the Loan Agreement agreeing to the issue of participation certificates ; (2) A Participation Agreement and (3) A Participation Certificate.

EXHIBIT I

SPECIMEN FORM OF PROMISSORY NOTE

Issued pursuant to the Agreement dated.........................

between——————————————————and——————————
(lending institution) (borrower)

Due on :

Rs.——————————

We (——————————————————————) promise to
(borrower)

pay at (the office of lending institution) (say IDBI, Bombay) on the......
day of............................197........... (without days of grace)
the——————————————————————————————
(name of lending institution)

or order the sum of Rs............ (Rupees............................
....only) and interest thereon
at.......................per cent per annum payable on..............June
and............December each year till payment, for value received.

Place :.......................

Signature of Borrower

Date :....................

Stamp

Pay..or order
(transferee)

....
(credit institution)

Transferred pursuant to the Agreement dated...............................

between...
(credit institution)

and...
(transferee)

CAGES FOR PAYMENT OF INTEREST

Serial No.	Date of Payment	Amount of Interest paid	Remarks

EXHIBIT II

AGREEMENT BETWEEN BORROWER AND CREDIT INSTITUTION: CLAUSES PROVIDING FOR THE CREATION OF PROMISSORY NOTES

Clauses on the lines of the following may be incorporated in the Loan Agreement between the Borrower and the Credit Institution, namely,—

(a) Terms of Loan :

(i) The Credit Institution agrees to take up transferable secured usance promissory notes (hereinafter referred to as "Notes") to the maximum extent of Rs............... (Rupees................................) (hereinafter referred to as "the Loan Amount") to be issued by the Borrower for the purposes and on the terms and conditions herein set out. The Notes will be taken up by the Credit Institution in instalments in accordance with a schedule to be submitted by the Borrower within a period of three months from the date of this agreement, such schedule to be subject to the approval of the Credit Institution.

(ii) Except as the Credit Institution and the Borrower shall otherwise agree in writing, the obligation of the Credit Institution to take up Notes as aforesaid shall cease on the................day of........ ....

(iii) The Notes shall bear interest at the rate of......................per annum and interest will be payable half yearly on the 20th June and 20th December of each year.

(iv) In case of default of payment of an instalment of interest or of the principal due on a Note the Borrower shall be liable to pay to the Credit Institution by way of liquidated damages, additional interest calculated at the rate of one half of one per cent per annum on the amount of principal then outstanding for the period of default.

Explanation : In this sub-clause the expression 'period of default' shall mean the period commencing from the date immediately after the date on which an instalment of principal or interest, as the case may be, has been last paid or the due date to which the last payment relates, whichever is later and ending with the date on which the instalment of principal or interest, as the case may be, in default has been paid.

(v) The Borrower shall pay to the Credit Institution a commitment charge at the rate of 1 per cent per annum on the amount of the Notes not taken up from time to time. Such commitment charge shall be payable for the period commencing from the date of this Agreement and shall be calculated half-yearly on the 20th June and 20th December of each year.

(vi) The Principal amount due under the Notes shall be repaid on the dates specified in the Notes.

(b) Security :

(i) To secure the principal amount due under the Notes, the interest thereon, commitment charge, costs and other charges as stipulated in these presents, the Borrower shall execute in favour of the Credit Institution a Trust Deed in a form and manner required by the Credit Institution charging to the Credit Institution as Trustee for the holders of the Notes, all the properties of the Borrower movable and immovable, present and future by way of legal mortgage in English form.

(Alternatively)

(i) To secure the principal amount of the Notes, the interest thereon, commitment charge, costs and other charges as stipulated in these presents, the Borrower shall charge in favour of the Credit Institution as Trustee for the holders of the said Notes, all its immovable properties by way of an equitable mortgage and all its movable properties by way of hypothecation. The Borrower shall also execute in favour of the Credit Institution in its capacity as such trustee a Trust Deed in such form and such manner as may be stipulated by the Credit Institution.

(ii) The Credit Institution shall not be under an obligation to take up the Notes unless and until the Borrower has complied with the requirements of sub-clause (i) of this clause.

EXHIBIT III

SPECIMEN AGREEMENT BETWEEN CREDIT INSTITUTION AND PURCHASER

"This Agreement made at..........this ....day of........19...... Between................ (name of credit institution) (hereinafter referred to as "the Credit Institution" which expression shall, unless excluded by the subject or context, mean and include its successors and assigns) of the One Part and...................... (name of the Purchaser) (hereinafter referred to as "the Purchaser," which expression shall mean and include his heirs, executors and legal representatives/ successors and assigns) of the Other Part

WHEREAS

(1) The Credit Institution has entered into an agreement with.................... (name of the company) (hereinafter referred to as "the Borrower") in terms of which the Credit Institution has agreed to take up secured usance promissory notes (hereinafter referred to as "the said Notes") for an amount not exceeding Rs..................(Rupees...........) to be issued by the Borrower.

(2) To secure the said Notes, the Borrower has charged to the Credit Institution, as the Trustee for the holders of the said Notes all its immovable and movable properties.

(3) The Borrower has also executed in favour of the Credit Institution as the Trustee for the holders of the said Notes, a Trust Deed dated the........day of...... 19..............which said Trust Deed is hereinafter referred to as "the said Trust Deed."

(4) The Credit Institution has since taken up the said Notes of the face value of Rs............(Rupees..............)

(5) The Purchaser has requested the Credit Institution to transfer to it/him/her the said Notes of the face value of Rs.......... (Rupees...........) as described in the schedule hereunder written and the Credit Institution has agreed so to do on the terms and conditions hereinafter set out.

NOW THIS AGREEMENT WITNESSETH that it is agreed by and between the Credit Institution and the Purchaser as follows :—

1. The Credit Institution shall transfer and the Purchaser shall accept the transfer of the said Notes of the face value of Rs....... (Rupees.......) as described in the schedule hereunder written on the terms and conditions herein after set out.

2. In consideration of such transfer, the Purchaser shall pay to the Credit Institution a sum of Rs.............(Rupees...... ....only) on receipt of which the Credit Institution will endorse and deliver the said Notes to the Purchaser.

3. The Purchaser shall not have any direct recourse to the Borrower for payment of any instalment of interest or principal due on the said Notes transferred pursuant to this Agreement. The Credit Institution will collect from the Borrower the instalments of interest due in respect of the said Notes and pass them on to the Purchaser at the cost of the Purchaser in all respects in a manner to be indicated by the Purchaser. The Purchaser shall deliver or cause to be delivered the said Notes to the Credit Institution for recording payments of interest from time to time. When the principal amount due on the said Notes or any of them becomes payable, the Purchaser shall deliver or cause to be delivered to the Credit Institution the said Notes which have become due, duly endorsed in favour of the Credit Institution and on receipt thereof, the Credit Institution shall pay to the Purchaser the principal amount due on the promissory notes provided the same have been received from the Borrower.

Note: For without recourse

OR

3. The Purchaser shall not have any direct recourse to the Borrower for payment of any instalment of interest or principal due on the said notes transferred pursuant to this Agreement. The Credit Institution shall be responsible for payment of the interest and repayment of the principal due on the said Notes and the same shall be paid to the Purchaser, at the cost of the Purchaser in all respects, in a manner to be indicated by the Purchaser. The Purchaser shall present or cause to be presented the said Notes to the Credit Institution for recording payment of interest. When the said Notes fall due for repayment, the Purchaser shall deliver or cause to be delivered the said Notes duly endorsed in favour of the Credit Institution.

Note: For with recourse

4. The Purchaser agrees that the transfer of the said Notes pursuant to this Agreement is subject to the provisions of the Loan Agreement, the said Trust Deed and also this Agreement.

5. The Purchaser shall not transfer the said Notes without the prior concurrence of the Credit Institution.

6. This Agreement shall be executed in duplicate and the stamp duty payable on this Agreement and its counterpart shall be borne and paid by the Purchaser.

IN WITNESS WHEREOF the Credit Institution has caused these presents and a duplicate hereof to be signed on its behalf and the Purchaser has signed these presents and the said duplicate the day and year first hereinabove written.

SCHEDULE

Particulars of Usance Promissory Notes

Serial No.	Amount	Date of Note	Date when due

SIGNED AND DELIVERED BY the Credit Institution

by the hand of.............. (name and

.... designation)

SIGNED AND DELIVERED BY the within named Purchaser,

....

EXHIBIT IV

CLAUSE IN LOAN AGREEMENT BETWEEN BORROWER AND THE CREDIT INSTITUTION AGREEING TO ISSUE OF PARTICIPATION CERTIFICATES

The Borrower agrees that the Credit Institution may, if it so desires, issue participation certificates in respect of the loan on such terms and conditions as it may desire and disclose the terms of the Loan Agreement to purchasers or prospective purchasers of such certificates.

EXHIBIT VI

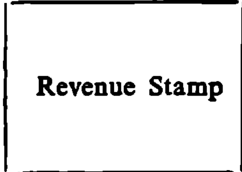
SPECIMEN FORM OF PARTICIPATION CERTIFICATE

THIS IS TO CERTIFY that.. (hereinafter called the Credit Institution) for value received has allotted to..................................(hereinafter called the Purchaser) a participation (hereinafter called the Participation) in the aggregate principal amount of Rs............. (Rupees................) in the loan (hereinafter called the Loan) to........................ (hereinafter called the Company), pursuant to a Loan Agreement (hereinafter called the Loan Agreement) dated...................19...... between the Credit Institution and the Company. A copy of the Loan Agreement has been supplied to the Purchaser.

2. The Participation in the Loan is in respect of the principal amounts and maturities, and will bear interest at the rate per annum as set forth below :

Principal Amount	Maturity	Interest
		% per annum payable in on and

3. This certificate is issued pursuant to the Agreement dated............. between the Credit Institution and the Purchaser.



Place : Signature........................

Dated : Designation.....................

43. The promissory notes or participation certificates may be sold either with recourse to the seller or without recourse. While some buyers may be willing to forego a part of the yield for the sake of the greater security offered by an instrument with recourse to the selling institutions, others may be prepared to assume greater risks and would expect a correspondingly higher yield. The implication of sale without recourse will be that in case of default, the transferee will have no claim on the term lending institution selling the participation certificate or the promissory note. The obligation of the selling institution will be to take measure in terms of the trust deed and the agreement between it and the transferee to realise the amounts due and share it among the participants on a *pro rata* basis. From the point of view of implementation of the scheme, we recommend that till the new instruments have gained acceptance in the market, they may be issued only with recourse to the selling institution. For the development of the market it is also essential that the institutions eligible for issuing the instruments should be only those approved for this purpose by the IDBI and the Reserve Bank, who as we indicate later have to offer certain facilities for the purchase/rediscounting of the instruments.

An existing scheme which can be dovetailed into the market for term loan instruments

44. In our view, the Bill Rediscounting Scheme of the IDBI, which has been in operation for over five years now, could partly be dovetailed into the market for the new instruments of loan participation recommended above. The Bill Rediscounting Scheme has been extensively used. The amount of bills rediscounted by the IDBI under the scheme was Rs. 7.09 crores in 1966-67 (July-June), Rs. 12.43 crores in 1967-68, Rs. 15.49 crores in 1968-69 and Rs. 24.07 crores in 1969-70. Although the scheme was originally introduced to assist the sale of machinery the demand for which was adversely affected by the recessionary conditions in the economy and it contains an element of concessive financing, it could serve as a useful form of financing even under normal conditions but without any concession in the rate of interest. Under the scheme as it has operated till now, the IDBI has made funds available to the rediscounting banks at an effective cost of a little over 6 per cent per annum. The discounting bank, *i.e.*, the seller's bank, which negotiates the bills which are invariably guaranteed by the purchaser's bank/insurance company, gets a spread of 2 per cent per annum on a set of bills for a period 5 to 7 years. The ultimate cost of credit to the purchaser of machinery, including the cost of the guarantee commission payable to the purchaser's bank and stamp duty works out to 10.85 per cent (Statement IX) which is almost the same as the cost of credit under a term loan for a similar period when account is taken of the cost of documentation, mortgage and service charges levied by banks on such loans. In our view, it should be possible to reduce appreciably the spread of 2 per cent available to the seller's bank and for the IDBI to charge a correspondingly higher rediscount rate, without raising the cost to the ultimate borrower. We feel that at least a part of the bill rediscounting business could be treated by the IDBI as normal commercial business on which it should earn a commercial return. In that event there would be no automatic recourse as at present to finance from the IDBI through the rediscounting of bills. The element of concessional financing by the IDBI could then be confined to specific sectors which are considered to be deserving special assistance.

The need for appraisal and follow-up

45. From the point of view of an investor in the instruments of term loans or instalment credit, the transaction is purely a financing one. He is not concerned with the appraisal of the project financed or the purpose of the loan, but will be guided by the standing of the borrower and the selling institution. In the circumstances, it is all the more necessary for the term lending institution (in the case of loan notes) and the accepting or guaranteeing institution (in the case of bills) to have prime regard to the appraisal of the project or the purpose of the credit and to follow-up the utilisation of the credit. Although in the case of bill financing where the assets to be acquired are only by way of small additions to, or replacements of existing machinery, etc., the scrutiny may be appropriately simple, it should not be dispensed with. In the absence of appraisal and scrutiny, there is a danger that the notes or bills may tend to

become mere accommodation papers with concomitant dangers of bad debts, financial indiscipline and misallocation of resources. In this context we should stress the need for systematic training of the large numbers of junior and middle level executives concerned with loan operations of the various credit institutions including commercial banks in appraisal methods. There should also be more systematic arrangements for imparting proper orientation and capacity for sound judgement to senior executives of these institutions through suitable trainihg programmes.

SECTION V

NEW INSTITUTIONAL ARRANGEMENTS; THE ROLE OF THE SECONDARY MARKET, INDUSTRIAL DEVELOPMENT BANK AND THE RESERVE BANK

46. We consider that one or more specialised institutions of the type of discount or acceptance houses—the number depending on the volume of business—would be necessary for the operation of the scheme. It would be useful to have such agencies which could act as brokers for effecting sales and purchases, hold the instruments for temporary periods when necessary, and do acceptance and guarantee services where these are needed. They may deal also in short-term bills besides the medium and long term instruments arising from term loans. In our view it would be advantageous if the commercial part of the Rediscounting Scheme of the IDBI as set out in paragraph 44 above and in paragraph 47 below is operated by a discount house supported by the IDBI. Such an institution can through specialisation develop the necessary expertise and could also have greater flexibility in its operations.

Need for a secondary market

47. Ordinarily an investor in the loan instruments can be expected to take up maturities which he could hold till the due date. Nevertheless, the marketability of these instruments will depend to a large extent on the assurance that they can be sold in a secondary market, in case the original buyer needs funds before the due date. The required liquidity for these instruments can be ensured if the IDBI operates a scheme for rediscounting these notes or bills at the normal market rate of interest for long term debt allowing a reasonable margin in favour of the discounting bank or institution. This "normal rate" or IDBI's rediscount rate should reflect the monetary authority's judgement as to what the long term rate should be, rather than the actual market rate prevailing at a point of time, which may be influenced by purely short term factors. The usance bills covered by the scheme may have to be prescribed by the IDBI for periods other than those covered by the RBI for the bills under the new Bill Market Scheme. For purchasing participation certificates, the IDBI Act will have to be suitably amended.

48. Secondly, if the participation scheme is to operate, the IDBI's present system of refinance will have to be replaced in areas other than the priority sectors (exports, small-industries and backward districts, etc.) in the main by a system under which IDBI will provide finance through rediscount of term loan notes at market rates as indicated above

rather than through refinance. Refinance will then be confined to special sectors where concessional terms are considered necessary. If IDBI resources are provided through purchase of participation instruments, this itself would make such instruments attractive to financial institutions and help to popularise the scheme.

49. We have also considered the question of an additional incentive for encouraging commercial banks to invest in promissory notes arising from loans of the term lending institutions. We note in this connection that from July 1971, borrowings by banks from the Reserve Bank against bills under the new Bill Market Scheme will not only be available at bank rate but also such borrowings will not impair their net liquidity ratio. We recommend that on the same analogy, term notes held by scheduled commercial banks which have an unexpired usance of 180 days in respect of export promissory notes and 90 days in respect of inland promissory notes should not only be made eligible for borrowing from the Reserve Bank at bank rate irrespective of the banks' net liquidity ratio but the borrowings against such bills should not also impair the banks' net liquidity ratio. This concession is necessary in view of the fact that as recommended above, the rediscount of these promissory notes by IDBI would be at market rates and not at any concessional rates.

50. As the statutes of the IFCI and SFCs as they stand at present do not provide for these institutions receiving, investing in or selling, promissory notes or participation certificates, it will be necessary to carry out appropriate amendments in these statutes to enable the IFCI and SFCs to participate in the scheme.

SECTION VI

51. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

1. Marketable instruments of term loans would help to develop the capital market by inducing a larger flow of savings to the financial institutions and to the industrial sector. The market mechanism would also help to co-ordinate the activities of the different lending institutions. Thirdly, the instruments would facilitate the flow of assistance for special purposes, such as export credit. Lastly, as in the case of the new Bill Market Scheme of the Reserve Bank of India, the creation of a market for instruments of term loans will help to absorb excess liquidity among financial institutions and reduce thereby their overall recourse to the Reserve Bank of India and the Industrial Development Bank, subject, however, to the qualification that at present there is no such excess liquidity among the financial institutions or the non-financial corporate sector, except of a purely short-term nature, which can be absorbed in short-term bills (Paragraphs 4, 5, 6 & 7).

2. The main instruments of savings in the form of financial assets with which the new market instruments of term loans will compete will be deposits with banks and non-banking companies and certificates of the Unit Trust of India. The commercial banks in India have a larger proportion of time deposits, particularly deposits for periods over two years, as compared with banks in some developed countries. To maintain their medium and long-term deposits, banks will have to offer on such deposits comparable rates of interest as on the proposed market instruments for term loans. The commercial banks can also maintain their volume of deposits through mobilisation of current deposits by increasing the public's reliance on the banking system for effecting and receiving payments (Paragraphs 9,10 & 11).

3. The answer to the question as to how far the new instruments will induce a larger volume of savings of the house-hold sector or a shift from non-financial assets like gold, jewellery or real estate to the new assets, and not merely divert savings from one financial asset to another will depend on the degree of differentiation of the instruments from the alternative financial assets like bank and company deposits and unit certificates, and the appeal that the instruments can have for particular

groups of investors. These factors can be determined only after the evolution of the market for the new instruments (Paragraph 12).

4. Against the background of the inability of the industrial borrowers to turn to the market directly for their needs on the one hand and the pressures on the resources of the lending institutions on the other, the new instruments of term loans will enable the lending institutions to act as intermediaries for the placement of industrial loans and securities in the market (Paragraphs 13, 14, 15 & 16).

5. In order to make the market instruments of term loans attractive for investment by commercial banks, it will be necessary that the yields on these instruments must be higher than the rates of interest available to banks on their short-term loans. Under the present structure of interest rates in India, the rates on short-term advances by commercial banks are 1 per cent to 1½ per cent higher than the rates charged by the specialised term lending institutions (8½ per cent) (Paragraphs 17 & 18).

6. The present structure of lending rates of term lending institutions reflects their dependence on the Government and monetary authorities for their resources. While this reliance of the term lending institutions on the Government and monetary authorities is the result of institutional factors governing the flow of savings in the economy and was justified in the initial stages of industrialisation when it was necessary to stimulate and ensure a specific pattern of industrial investment, continued reliance of the institutions on created money will result in inflationary financing. It would be desirable for the institutions to derive at least a part of their re sources from the market and also charge the market rates on a part of their transactions. The term lending institutions must aim at realising an average return on their funds (used for the purely commercial part of their transactions, and taking together term loans and investments) which is higher than the interest on short-term loans. Operation at market rates will imply that there will be differentiation in rates as between different concerns, whereas at present the term lending institutions derive most of their funds from the same source (Government or monetary authorities) at uniform rates and charge, in turn, uniform rates on their loans (Paragraphs 19, 20 and 21).

7. Against the background of a banking sector, the deposit growth of which has lagged behind the demand for credit emanating from the several sectors of the economy and the limited liquidity in the non-financial corporate sector, the market for term loan instruments is to be ultimately largely based on the mobilisation of additional savings of the house-hold sector. But this can come about only over a period of years and that too if there is an environment conducive to the generation of voluntary savings. The perspective to be kept in view, while introducing any scheme for marketing of term loans should, therefore, be a long term one (Paragraph 24).

8. There are two broad categories of term loan participation arrangements between credit institutions, namely, (*i*) administrative co-ordination, involving consortium arrangements or joint financing and (*ii*) participation through market instruments (Paragraph 25).

9. The essential features of a scheme for co-ordination of assistance among financial institutions should be common appraisal, sharing of security and common follow-up. Some State Financial Corporations and commercial banks have already adopted schemes for joint financing/co-ordination of loans. We recommend that these arrangements should be strengthened and extended (Paragraphs 28 & 29).

10. In order to encourage common appraisal and follow-up procedures it is necessary that the financial institutions should share freely with each other credit information. For this, the institutions should be protected by legislation against any action for damages by parties who may be adversely affected by credit reports. We recommend that the question of suitable legislation for this purpose must be urgently taken up (Paragraph 30).

11. There are four existing schemes for loan participation through marketable instruments, namely, (*a*) schemes based on the sale or discounting of promissory notes of the borrower, (*b*) schemes based on participation certificates similar to those issued by the International Finance Corporation (Washington), (*c*) those based on participation certifica-

tes similar to the ones issued by some commercial banks in India, and (*d*) those based on privately placed debentures. A fifth possible scheme would be for a term lending institution to form a balanced portfolio consisting of some of its loans and equity investments and to sell portions of such portfolio in the form of unit certificates. Where a term lending institution has built up a sufficiently diversified portfolio and if there is provision for continuous management of the portfolio, there could be a scheme to sell units based on such portfolio. For the scheme to succeed it is necessary that it should enjoy a tax concession which is enjoyed at present only by the Unit Trust of India (Paragraphs 32 & 33).

12. Participation certificates which are unrelated to particular maturities of term loans and are of relatively short maturities will be virtually identical to fixed deposits (Paragraph 34).

13. The instrument of debentures has the following disadvantages which will limit its use in loan participation arrangements: (*a*) there are cumbersome administrative procedures involved in the issue of debentures; (*b*) there are relatively high stamp duties on each transfer of a debenture; and (*c*) as a debenture will not be carrying any endorsement by a lending institution, its acceptability will depend entirely on the investors' confidence in the borrowing concern issuing the debenture (Paragraph 35).

14. We recommend a scheme for participation based on promissory notes or participation certificates similar to those issued by International Finance Corporation (Washington.) The choice between the two instruments may be made by the lending institution concerned. The main factor influencing the choice will be the differences in stamp duty between the two instruments. Participation certificates involve stamp duties levied by State Governments. These duties are levied on each transfer of the instrument and vary from State to State. In order to propularise their use, the State Governments should levy a flat, uniform and low rate of stamp duty on such certificates. Promissory notes involve stamp duty payable to the Central Government. The duty is payable only for the creation of the instrument and not for subsequent transfers. In order to encourage the marketing of loans through promissory notes, we recommend that the Central Government should reduce the stamp duty on promissory notes created in favour of commercial banks and term lending institutions. This can be done through an appropriate administrative notification (Paragraph 36).

15. To ensure that the security available to the lending institution is also available to the transferee of the market instruments (promissory note and/or participation certificates), it is recommended that the security may be created in favour of the lending institution which will act as a trustee for the issue. It would be convenient if all transfers of promissory notes are registered with the lending institution (as in the case of debentures) and the lending institution acts as trustee for the holders of the notes to collect the amount payable to them and make payments to them so that they need not deal directly with the original borrower. These conditions can be incorporated in an agreement between the lending institution and the transferee and it can be printed on the instrument that it has been transferred to the holder by the lending institution in pursuance of the agreement (Paragraphs 37 & 38).

16. Promissory notes may be created only as and when needed, so as to obviate avoidable stamp duty. For this, it is recommended that the lending institution may take from the borrower at the time of each loan disbursal, an undertaking to execute promissory notes for the outstanding balance of the loans and interest due and also an irrevocable power of attorney for the creation of promissory notes on his behalf as and when the institution considers it necessary (Paragraph 39).

17. The minimum face value of a promissory note or participation certificate under the scheme may be, say, Rs. 5,000 (Paragraph 40).

18. The promissory notes or participation certificates may be sold either with or without recourse to the issuing institution. We recommend that initially they should be issued only with recourse and the institutions eligible for issuing the instruments should be only those approved for this purpose by the IDBI and the Reserve Bank (Paragraph 43).

19. The present Bill Rediscounting Scheme of the IDBI can be dovetailed into the market for instruments of term loans. The IDBI may treat a part of its bill rediscounting business as normal commercial business and charge a commercial rate on the bills (Paragraph 44).

20. It is important that the lending institution (in the case of participation certificates and promissory notes) and the accepting or guaranteeing institution (in the case of bills) should undertake careful appraisal and scrutiny of the purpose of the credit and follow up the utilisation of credit. There is need for systematic training of the executives concerned with loan operations of the various credit institutions (Paragraph 45).

21. It would be useful to have specialised institutions like discount or acceptance houses to act as agents for effecting sales and purchases of the new instruments, to hold the instruments for temporary periods when necessary, and to render acceptance and guarantee services where required. The commercial part of the Bill Rediscounting Scheme of the IDBI may be operated by a discount house supported by IDBI (Paragraph 46).

22. To enhance the marketability of the new instruments, it is necessary to ensure a degree of liquidity for the instruments. For this, the IDBI may operate a scheme for rediscounting promissory notes or bills at market rates of interest. The market rates for this purpose should be the rates which the monetary authorities would consider to be the normal long-term rate for the transaction. For the IDBI to purchase participation certificates, it would be necessary to amend the IDBI Act (Paragraph 47).

23. In order to popularise the use of participation instruments, it is recommended that IDBI's resources may be provided to the lending institutions mainly through the purchase of participation instruments. IDBI's refinance should be confined to special sectors where concessional terms are considered necessary (Paragraph 48).

24. An additional incentive for encouraging commercial banks to invest in promissory notes arising from term loans would be for the Reserve Bank to lend against such notes held by scheduled commercial banks, which have an unexpired usance of 180 days in respect of export promissory notes and 90 days in respect of inland promissory notes, at the Bank Rate irrespective of the banks' net liquidity ratio; the borrowings against such bills should not also impair the banks' net liquidity ratio (Paragraph 49).

25. For the Industrial Finance Corporation and the State Financial Corporations to participate in the purchase or sale of promissory notes or participation certificates, it will be necessary to amend their statutes (Paragraph 50).

* * *

Acknowledgements

52. The Chairman and the Member-Secretary had the benefit of exchanging views on the subject matter of the report with Shri James S. Raj, Managing Director, Industrial Investment Trust Ltd. and Shri R. S. Bhat, Chairman, Unit Trust of India. They also had the benefit of the comments of Dr. V. V. Bhatt, General Manager, Industrial Development Bank of India. The Group would like to place on record its appreciation of the valuable work of Shri Philip Thomas in the preparation of the Report. Shri D. G. Borkar and his colleagues in the Industrial Finance Department of the Reserve Bank of India did an excellent job in assembling the material contained in the Annexures to the Report.

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Promodh Malhotra *Member*

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A. Raman *Member*

N. V. Sundaram *Member*

V. S. Raghavan *Member*

Philip Thomas *Member-Secretary*

Bombay,

March 25, 1971

ANNEXURE I

EXTRACTS FROM A NOTE ON "BUYERS' CREDIT AND FINANCIAL GUARANTEES"

By

Shri T. R. Varadachary, Chairman,
Export Credit and Guarantee Corporation and Managing Director, State Bank of India

A good beginning has already been made in capital exports from this country. Entering as we do a field where there is fierce competition from highly advanced countries, our exporters suffer from an inevitable handicap and extension of liberal credit facilities is a *sine qua non* for this business. In several large transactions in the recent past, suppliers' credit has been extended and, on the basis of appropriate ECGC cover and participation loan arrangements betweeen commercial banks and the IDBI, these deals have been put through with credit terms for varying periods. Suppliers' credit, however, has its limitations. For one thing, the credit period cannot be too long as, otherwise, the supplier will have to carry the liability for an unduly long period. Again, a company which is predominantly export-oriented is also the worst affected under the system of suppliers' credit. With a large part of its sales being diverted abroad on extended credit terms year after year, a situation would soon arise where the company's receivable will get bloated to unduly large dimensions. No doubt, these receivables are adequately matched by term borrowings from commercial banks and the IDBI. It will be readily appreciated, though, that the finance obtained from commercial bank and the IDBI is basically a borrowing in so far as the company is concerned and will thus distort the debt/equity relationship as seen from the balance sheet, until a stage is reached where the company's financial gearing will be quite unacceptable. It is particularly unfortunate that a company engaged mainly in engineering exports will be the most affected under these circumstances.

Need for Buyers' Credit

2. While suppliers' credit has increasingly come into vogue, there are thus serious limitations to this approach as a means of increasing engineering exports. In developed countries abroad which have also faced a similar situation with a widening of the scope of exports and increase in the amounts of credit and duration thereof, the system of extending buyers' credit has developed as part of their response to this change.

3. Briefly stated, a buyers' credit envisages extension of credit by the financing bank in the exporting country directly to the foreign buyer (or his banker). Instead of the exporter extending credit to the foreign buyer and obtaining loan facilities from his banker against the deferred receivables, the exporter arranges with his banker to extend credit directly to the buyer. The credit will, of course, be guaranteed by the buyer's banker, as in respect of suppliers' credit. The difference is that the foreign buyer pays off the supplier outright with the proceeds of the loan, with the result that the supplier need not be burdened with the receivables for a number of years. With the emergence of the buyers' credit procedure, suppliers' credit is no longer extended for long periods and is generally restricted to 5 years, as in the U.K. Exports involving longer credit periods are handled under buyers' credits, against financial credit guarantees extended by credit insurance agencies.

4. The advantages of this procedure are obvious. In so far as the supplier is concerned, he obtains immediate payment and there is no necessity for him to carry excessive amounts of receivables and corresponding bank borrowings in his balance sheet. Again, the risk of non-payment, however small, is also taken over by his banker. On the banker's side, no additional risk will devolve on him as the credit extended by him to the foreign buyer will be covered by adequate financial credit guarantees from the export credit insurance agency besides, of course, the guarantee of the buyer's banker. This procedure is particularly suitable in respect of large "turnkey" contracts for supply and erection of complex manufacturing facilities

abroad. If our own exports of engineering capital goods are to register a large increase in the coming years, there is no alternative to our introducing the system of buyers' credit in our country as well.

Mechanics of Operating Buyers' Credit

5. An essential pre-requisite to introducing the buyers' credit procedure in this country is the introduction of financial credit guarantee cover by the ECGC to cover the lending risks of the financing agency. Assuming that ECGC will be in a position to evolve suitable arrangements for this purpose, the mechanics of the buyers' credit operation for individual contracts will be more or less on the following lines :

(*a*) The first step will be the drafting of the terms of the contract between the Indian exporter and the foreign buyer. Besides embodying the terms and conditions relating to specifications, inspection procedure, performance guarantees and other matters incidental to such a transaction, the contract will also stipulate the payment terms and outline the possibility of securing buyers' credit from a designated financing bank in the country.

(*b*) Before finalising the contract, the exporter will hold discussions with the financing bank and ECGC and seek their approval for the terms of the contract. In particular, the financing bank and ECGC will have to agree to the payment terms and the security offered by the buyer for the deferred payments. The security will usually comprise promissory notes for the deferred instalments and interest, with an irrevocable guarantee from an acceptable bank in the buyer's country agreeing to pay the deferred instalments on the stipulated dates on default by the buyer. An initial letter of commitment from the buyer's banker will also be necessary.

(*c*) In the next stage, the buyer will have to be brought in touch with the financing bank and ECGC. This can be done either by a composite team going out to the importing country when all the loose ends can be tied up on the spot, or, alternatively, the buyer may be invited here for further discussions.

(*d*) Simultaneous with finalising the supply contract, the buyer will also enter into a loan agreement with the financing bank in this country, agreeing to utilise the loan for payment to the suppliers. The loan agreement will contain provisions relating to the terms and conditions of disbursement, documents to be produced by the supplier when claiming payments, security , procedure for dealing with promissory notes and banker's guarantee and other necessary warranties. Alongside, the financing bank will also seek ECGC financial credit guarantee cover.

(*e*) The supply contract should stipulate a suitable down-payment, say, 20 per cent of the contract price, the balance being payable by way of deferred instalments. The balance of 80 per cent will be the amount of the loan to be extended by the financing bank and the question is what should be the extent of ECGC cover. ECGC can either guarantee the entire balance of 80 per cent (or in other words 100 per cent of the loan granted by the financing bank) or a portion thereof. Until we gain some experience of the operation of the buyers' credit system, my own view is that ECGC cover should be restricted to 95 per cent of the loan granted by the financing bank and interest, the risk in regard to the balance of 5 per cent being borne by the exporter. This is the system followed by COFACE in France. For this purpose, a separate agreement will have to be entered into between the exporter and the financing banker, whereby the banker will be indemnified up to the extent of 5 per cent of the loan granted to the foreign buyer. It would be seen that in so far as the financing bank is concerned, it will be fully covered to the extent of 95 per cent of the loan and interest by ECGC guarantee and, for the balance, it will have to look to the exporter, in the event of default by the buyer and his banker.

(*f*) In regard to documentation, the question arises whether it is necessary to have promissory notes to evidence the borrowers' liability, in addition to the loan agreement. It may be mentioned in parenthesis that promissory notes are not insisted upon by term lending institutions for rupee term loans within the country. Examining the *pros* and *cons*, I am inclined to the view that it would be

of advantage to ask for promissory notes from the foreign buyer in addition to his banker's guarantee as the legal implications of promissory notes executed for value received are well-known internationally, and the chances of future disputes can thus be reduced to a minimum.

(*g*) Once it is agreed that promissory notes should be obtained for the deferred instalments both principal and interest, the procedure therefor has to be determined. Here again, the practice varies from country to country. One method is for promissory notes for principal and interest to be initially deposited with the financing bank acting first as a trustee bank. As and when exports are effected by the supplier, claims are submitted by him to the financing bank in terms of the provisions of the supply contract and loan agreement. The buyer, on his part, leaves irrevocable instructions with the bank to release promissory notes of adequate value to the supplier as and when claims (conforming to certain requirements and accompanied by suitable certificates and documents) are submitted by him to the bank. These promissory notes received by the supplier are, in turn, sold by him to the bank and full payment thereof obtained. It will be seen that the bank acts in a dual capacity, first as a trustee bank holding the promissory notes and then as a financing bank purchasing the promissory notes from the supplier who has received them earlier for supplies made.

(*h*) A noteworthy feature of the arrangement is that the purchase of promissory notes by the bank from the supplier is *without recourse* to the supplier. In other words, in the event of default by the buyer and his banker who has guaranteed repayment, the risk will not devolve on the supplier. This concept is central to the entire arrangement. My recommendation in this regard is that, as mentioned earlier, the exporter should bear 5 per cent of the risk.

(*i*) An alternative to the above will be for the financing bank to effect disbursements straightaway to the supplier against claims made for exports. Disbursements will be made against irrevocable instructions recorded by the buyer with the financing bank ; these instructions would set out the circumstances in which disbursements should be made and specify the documents and other assurances to be obtained from the supplier at the time of disbursement. Accounts will be rendered to the buyer from time to time as and when debits are raised by the financing bank against disbursements made to the supplier. After all supplies have been effected and the full amount of the credit is utilised, the buyer will thereafter draw two sets of promissory notes for principal and interest respectively, and forward them to the financing bank.

(*j*) Under both alternatives outlined in (*g*) and (*i*) above, the buyer's liability will be fully covered by an irrevocable guarantee issued by his banker along with an undertaking, if possible, from the Central bank of the country in regard to release of foreign exchange for meeting the deferred payments. The wording of the guarantee will, of course, differ according to circumstances and the actual procedure adopted.

(*k*) The responsibility of the supplier to fulfil his part of the supply contract is in no way less than under the suppliers' credit procedure. The supplier would continue to be bound by all the provisions of the supply contract and payments will be made to him only on his fulfilling his responsibilities under the contract and on his complying with all the conditions precedent to claiming payment for exports ; these might include submission of shipping documents and offer certificates as required in the supply contract, preshipment inspection certificates, marine insurance policies, certificate from the buyer's side relating to completion of import regulations, etc.

(*l*) On the due dates, the financing bank will arrange for presentment of promissory notes for payment in whatever manner that might have been agreed upon, risk of non-payment by the buyer and his banker being covered by the ECGC guarantee and supplier's indemnity for 95 per cent and 5 per cent, respectively.

(*m*) An alternative to extending credit to the buyer against the guarantee of his banker with exchange control clearance from the

Central bank in the buyer's country, will be to grant the credit directly to the buyer's bank (acting on behalf of the buyer) with the guarantee of the Central bank of the country. This arrangement will be particularly suitable in dealing with the developing countries. The divorce between the supply contract and the loan transaction is complete under this type of arrangement and the chances of any dispute between the buyer and the seller affecting the borrowing relationship is completely eliminated.

(*n*) To start with, buyers' credit may be restricted to contracts of Rs. 1 crore and above involving credit periods of not less than 5 years.

(*o*) The buyers' credit should not ordinarily exceed the cost of goods and services in India. Outside costs or cost of bought-out components from abroad should be covered by the down payment as far as possible, the principle here being that credit should cover only Indian supplies. A flexible approach would, however, be needed in this matter and relaxations may be necessary in some cases.

6. While the foregoing sets out the broad outline of the buyers' credit arrangement, detailed operating techniques will have to be spelt out only after examining all legal aspects. The actual procedure will also depend on whether a contract will be governed by the laws of our country or by those obtaining in the importing country. While we would naturally desire that all buyers' credit contracts should be based on Indian laws, it must be stated that certain suppliers' credits handled in the recent past have countenanced the jurisdiction of the laws of the foreign countries concerned.

Organisational Frame-Work

7. The organisational angle will also have to be considered. In the case of a suppliers' credit, the existing procedure is for the supplier to approach his banker who, in turn, gets in touch with IDBI for evolving a participation arrangement; the supplier also contacts IDBI directly. This procedure is resulting in considerable delays as the supplier has to approach four different agencies before any decision could be taken, *viz.* his own banker, IDBI, ECGC and the Exchange Control authorities. In the buyers' credit arrangement, a far higher degree of co-ordination between the respective agencies would be called for. The long term aim must be to have one specialised bank—perhaps an Export-Import Bank—which can deal with the supplier directly and assume full responsibility for effecting co-ordination amongst various agencies. The Export-Import Bank may, if necessary, sell participation loan certificates to other commercial banks for raising resources; even LIC might possibly be interested in such certificates. Until such time as this materialises, it will be necessary for consortium arrangements to to be evolved for handling large buyers' credits.

8. Immediately an exporter comes forward with a request for a buyers' credit arrangement, a standing committee could be established, consisting of representatives of the IDBI, ECGC, Exchange Control authorities and the participating banks. This standing committee should handle the entire processing jointly and their views ought to be acceptable to all the agencies concerned. The advantage of this procedure will be that individual processing of the proposals by four different agencies can be eliminated and the entire mechanics of the operation streamlined.

Limitations of Commercial Banks

9. As mentioned in an earlier paragraph, buyers' credit, being intended mainly for large contracts and for extended credit periods, cannot be handled entirely by commercial banks. Notwithstanding the changed role of commercial banks after nationalisation, the commercial character of their operations would still largely prevail. Export financing by commercial banks would be mainly in the short-term field and, to some extent, in medium-term financing of exports by way of suppliers' credits. In respect of buyers' credit, however, commercial banks can play only a limited role and it is for this reason that the possibility of creating a special agency for this purpose has been referred to earlier. Until such time as a specialised agency is set up, the IDBI will have to play the lead-bank role. The supplier's banker will, of course, be

associated in extending buyers' credit and will participate in the consortium loan arrangement. Having regard to the limitations of commercial banks, I would suggest that where they join such a participation loan arrangement, they should get the earlier maturities. The principle that commercial bank should take the earlier maturities is well accepted abroad—as in France for instance—and a similar convention will have to be developed in our country too. If commercial banks are assured that their participation will not extend beyond, say, the first 5 years of the arrangement, there will be sufficient inducement for them to promote this type of export activity. Maturities beyond 5 years will be taken up by the specialised financing bank or by the IDBI. I have earlier referred to the possibility of bringing in LIC into the financing arrangement and, should this materialise, LIC might be willing to take the longest maturities, with the specialised financing bank and IDBI taking the middle maturities.

ANNEXURE II

PARTICIPATION ARRANGEMENTS INVOLVING MARKETING OF LOANS

(a) Sale of loan promissory notes

Under this arrangement the lending institution takes promissory notes of different maturities from the borrower at the time of making the loan and these notes are sold or discounted as and when the lender needs replenishment of its funds. The International Bank for Reconstruction and Development, for instance, effects periodically sales of promissory notes executed by borrower Governments or oganisations with Government guarantee, from its loan portfolio.

(b) Sale of Participation Certificates as in the case of the International Finance Corporation (Washington)[IFC(W)]

Objectives of IFC and its policy regarding sales of investments

The purpose of IFC is to further economic development by encouraging the growth of productive private enterprises in its member countries, particularly in the less developed world. Direct investments in individual productive private enterprises are the principal means by which IFC caries out this mandate.

IFC seeks to revolve its funds—and to encourage the growth of markets for the types of securities in which it invests—by selling its investments to private investors whenever it can appropriately do so on satisfactory terms.

Investors are invited to participate in IFC investments, either at the time of IFC's original commitment or later. In the former case, the participation is on the same terms as IFC. In the latter case, the terms are agreed upon in the light of developments subsequent to the original commitment date.

Participations—General

IFC's investments are not guaranteed by any government. When IFC makes a sale of a participation in a loan or equity, it does so without recourse to IFC. IFC does not stand between the participant and the company in the sense of being responsible for liabilities. This means, in fact, that the participant shares on a *pro rata* basis in any profits or losses sustained by IFC in a particular investment.

There are two principal ways in which IFC makes a sale of participation. One of them involves agreement on the part of the participant in advance of a new commitment by IFC to take over a portion of the commitment, in which case IFC sells a participation at the same price that IFC is acquiring its investment. In this way IFC normally can arrange for the participant to be named in the various press releases and other material publicizing the transaction and, of course, a commercial bank has an opportunity to obtain collateral business for itself in connection with the transaction. Such participations normally take the form of a *pro rata* interest in the entire commitment of the loan and equity or, alternatively, a portion of the early maturities of the loan or equity.

Secondly, IFC engages in portfolio sales, that is, selling part of the shares and the debt IFC is holding in various investments to private investors after the transaction has been completed. In this case, investments are sold at prices which are negotiated. These sales normally take the form of participations in particular portions of either the loan or the equity alone, and sometimes in a *pro rata* interest in the entire commitment.

Participations in Loans

In the case of the loan portion of an investment, IFC expects to continue to hold and administer the loan so that all the payments are made to IFC and IFC accounts to the participant or purchaser for its *pro rata* share. In many cases IFC could deliver notes of the enterprise, if desired, but this is unusual. In almost all countries, IFC has received rulings to the effect that IFC's immunities are not affected by reason of foreign participations, so that there is no tax withholding in the country concerned and IFC correspondingly accounts to the participant or purchaser gross and without deduction. When IFC sells a participation in one of its loans, it does not deliver notes of the Company to participants but issues a participation certificate. This certificate, in the form of the attached specimen, governs the relationship between IFC and the participant lender. A record of the total amount of the agreed participation, the interest, maturities, disbursement arrangements and any other matters relating to the particular deal are covered in the letter of agreement exchanged by IFC and the participant. A specimen of this letter is also attached.

IFC charges a commitment fee at the rate of 1 per cent per annum upon the undisbursed portion of its investment and participants share in this fee if the participation commitment is given before disbursement.

Participations in Equity

IFC does not issue any participation certificates covering equity. In regard to a purchase of equity from IFC, shares are issued by the company in the name of the participant. After that the participant is a shareholder and deals directly with the company concerned. Every participant in equity has to work out its own tax position. However, IFC and the participant do enter into an agreement which reflects the terms of the sale of equity by IFC and the purchase by the participant.

Main Features of the Scheme

There are several interesting features of IFC's scheme of participation certificates which have contributed to a successful means of mobilising resources. Under IFC's scheme, that buyer of a participation certificate gets only a beneficial interest in the portion of the particular loans which he buys. The buyer becomes entitled to receive the instalments and the interest on the portion bought by him.

IFC will collect the instalment and interest on his behalf. The sale is without recourse to IFC, and the buyer has to share in all the risks of non-payment or rescheduling of the principal or interest. IFC remains solely responsible for the follow-up of the loan and for dealing with the borrower, although it undertakes to consult the participants in case any variation is to be made in the original terms of the loan. Such consultation, however, does not give the buyer any right of veto and any decisions regarding changes in terms or enforcement of securities will be solely at the discretion of IFC. In essence, the participant buys the certificate because of his faith in IFC's appraisal of the project concerned and the attractive yield on it consistent with its soundness as a security.

From the point of view of the buyers of IFC's participation certificates, the main advantages are the realisation of a relatively high rate of interest and the avoidance of the administrative costs in appraising and following up of loans, since these tasks are undertaken by an expert body like IFC at a reasonable cost. In order to make the scheme attractive to participants, IFC generally passes on the entire benefit of the interest rate to the buyers of its participation certificates. The rate of interest on IFC's loan and hence the rate receivable by the participant is a fixed one and not a floating rate. The advantage of a fixed rate is that the bor-

rower can have certainty about the interest cost that he has to bear. Although the rate to be charged on a particular loan would be determined by the prevailing conditions in the long term market, it is not considered desirable that once the rate on a loan has been fixed, it should fluctuate with changes in credit conditions.

Another attraction which IFC offers the participant is a share in the equity of the borrowing concern. It may be noted that IFC generally never makes a loan without getting some part of the equity in the borrowing concern. When IFC appraises a project and finds it worthwhile, it also wants to share in the growth prospects of the assisted concern and it insists on some equity. The share of equity which IFC can get will depend on the relative bargaining position of the parties at the point of time of making the loan. IFC, which thus acquires a share in equity along with its loan, generally sells to the participants a 'strip' of its investment consisting of loans and equity in the same concern. The buyer, in other words, gets a *pro rata* share in equity along with his purchase of loan participation certificate. In respect of the equity which the participant gets, the participant becomes entitled to all the rights in that equity and IFC is no longer concerned with that portion of the equity. The price at which IFC acquires the equity or later sells it to the participant (who buys a 'strip') is the price current at the time of the transaction.

IFC's participation certificates are mostly taken up by banks who generally take maturities up to two years. As IFC's loans are repayable in six-monthly instalments, a bank may buy, say, 4 such instalments falling due in the next two years. This does not, however, mean that only two-year maturities of any particular loan are taken up by a bank. Generally, if a bank has bought maturities for two years and at the end of the period, IFC informs it that there are further maturities available on the same loan, the bank may take another portion of the loan covering the instalments falling due in the next two years and the process may continue till the last maturity of a loan.

Sales of participation certificates of a particular loan are made by IFC both at the time of extending the loan as also after the loan has run for some time. In some instances, the buyers prefer to watch the progress of the assisted concern before going in for participation share. At the same time, there is also an incentive for banks to join in the participation scheme in the initial stage itself, because by doing so, they become entitled to a share in the commitment charge on the balances remaining to be drawn. IFC's commitment charge of 1 per cent is relatively attractive. As the disbursement of a loan takes place in stages, the participants also make *pro rata* contribution to each disbursement, but in the meanwhile they are entitled to a *pro rata* share in the commitment charge.

INTERNATIONAL FINANCE CORPORATION

SPECIMEN PARTICIPATION AGREEMENT

Participation Agreement

Investment No........

Date..................

Gentlemen :

Reference is made to the Investment Agreement dated————————, 19———— (the Investment Agreement) between International Finance Corporation (IFC) and———————————————————— (the Company) whereby IFC has agreed to make a loan (the Loan) to the Company in the amount, for the purpose and on the terms and conditions set forth therein. A conformed copy of the Investment Agreement has been provided to you.

In consideration of the sum of (US$——————————), payable by you as below provided, IFC has allotted to you a participation in the Loan on the following terms:

1. Your participation in the Loan will be in respect of the principal amounts and maturities, (will carry entitlement to premium

Note: Adapt as required.

on prepayment) and will bear interest at the rate per annum, all as set forth below :

Principal Amount	Maturity	Interest	Premium (On Prepayment)
(US$)		—% per annum payable in (US dollars) on——— and———	

IFC reserves the right to sell or transfer, for its own account, any part of the Loan which is not comprised in your participation.

2. IFC will request remittance by you on account of your participation only as needed to meet, or to reimburse IFC for, withdrawals by the Company under the Loan. Each such remittance shall be made upon not less than (72) hours' written or telegraphic notice (Saturdays, Sundays and bank holidays being excluded). Upon receipt of such notice, you will, on the date specified therein, remit (in Federal Reserve Bank of New York funds the amount specified therein to the Federal Reserve Bank of New York for the account of IFC).

3. IFC will, upon receipt from (the Federal Reserve Bank of New York) of advice that the amount of (IFC) has been credited with such remittance, deliver to you a Participation Certificate substantially in the form annexed hereto, dated the date of such credit and in the amount thereof, to evidence your participation. Your entitlement to participation in the Loan shall begin on the date of such Participation Certificate and be to the extent specified therein.

Note: Commitment charge is payable in the currency in which the *Loan* (not necessarily the Participation) is denominated.

Note: Adapt as required.

4. IFC will pay to you in U.S. dollars (but only proportionately out of amounts received by it by way of commitment charge under the Investment Agreement) a commitment charge at the rate of 1 per cent per annum on the principal amount of your participation from time to time remaining unremitted by you. (For purposes of computing commitment charge, an exchange rate of——— = US$ 1 will be used.) Your right to commitment charge shall accrue from (the date from which commitment charge shall accrue as provided in the Investment Agreement) (the date hereof) (———, 19———) and such right shall cease to accrue as of the date on which a remittance is due from you as above provided, with respect to the amount of the remittance then due. Such commitment charge shall be payable to you semi-annually as promptly as practicable after receipt of corresponding amounts by IFC from the Company and shall be computed on the basis of a 360-day year of twelve 30-day months.

5. IFC may at any time, by notice to you, reduce the principal amount of your participation, except in respect of amounts previously remitted by you. Commitment charge shall thereupon cease to accrue upon the amount by which your participation shall be so reduced.

6. The provisions contained in the form of Participation Certificate annexed hereto shall be deemed a part of this agreement and shall be binding between us as though they were fully set forth herein.

(7. We understand that your participation hereunder is being acquired by you for your own account and not with a view to resale or distribution, it nevertheless being understood that the disposition of any part of your participation is in your control.)

8. Any notice hereunder shall be in writing or by telegram and may be sent by either party to the other at its address set forth herein or to such other address as either party by notice shall have designated. Any such notice shall be effective upon receipt.

Please confirm your acceptance of this participation on the terms set forth above by signing and returning the enclosed copy of this letter.

Very truly yours,

INTERNATIONAL FINANCE CORPORATION

By———————

Confirmed :

———————

By ———————

SPECIMEN

No. AC

INTERNATIONAL FINANCE CORPORATION

Investment
No.

PARTICIPATION CERTIFICATE

THIS IS TO CERTIFY that International Finance Corporation (hereinafter called IFC) for value received has allotted to............ ....or registered assigns (hereinafter called the Participant) a participation (hereinafter called the Participation) in the aggregate principal amount of............ .... in the loan (hereinafter called the Loan) to .... (hereinafter called the Company), evidenced by an Investment Agreement (hereinafter called the Investment Agreement) dated.... ...., 19............between IFC and the Company. Copies of the Investment Agreement and the Notes issuable thereunder (hereinafter collectively called the Loan Documents) have been supplied to the Participant.

1. The Participation in the Loan is in respect of the principal amounts and maturities, will bear interest at the rate per annum and carry entitlement to premium on prepayment as set forth below :

Principal Amount	Maturity	Interest	Premium on Prepayment
		% per annum payable in on and	

The Participation is limited to the principal, premium (if any) and interest specified above and does not include any other part of IFC's investment in the Company. The Participation is prepayable by IFC at any time at par plus premium as above and accrued interest.

2. IFC will promptly pay to the Participant all sums received by it on account of the principal of, premium (if any) and interest (from the date of this Participation Certificate) on, the part of the loan represented by the Participation. Any taxes or other charges applicable to such part of the Loan shall be for the account of the Participant.

3. The administration and exercise of rights under the Loan Documents, including all matters provided for or contemplated by any of the Loan Documents, will be handled solely by IFC. The Participant agrees, by acceptance of this Participation Certificate, to pay to IFC its *pro rata* share of any out-of-pocket expenses incurred by IFC in the protection or enforcement of rights under the Loan Documents. IFC will exercise the same care in the administration and enforcement of rights under or in relation to the Loan Documents as it exercises with respect to Loans which are for its own account and IFC will have no further responsibility to the Participant in respect thereof. Without prejudice to the generality of the foregoing, IFC specifically reserves the right, in its discretion and without notice to the Participant, to exercise, refrain from exercising or waive any rights under or in relation to the Loan Documents or any other agreement, with the Company (or any Guarantor) or to modify any provisions thereof; provided, however, that IFC will not, without the Participant's consent in writing, amend, or waive, or give any consent under, any provisions of the Loan Documents or other agreement as aforesaid which would vary the obligations of the Company (or any Guarantor) to pay, in the currency and on the date or dates stated above, the amounts of principal, premium (if any) and interest payable on such date or dates. IFC makes no representation or warranty as to the merits of the investment, the financial condition of the Company (or any Guarantor), the validity of the Loan Documents or the performance by the Company (or any Guarantor) of the obligations contained therein.

4. This Participation Certificate is transferable by the Participant, or by the Participant's attorney duly authorised in writing, upon presentation and surrender thereof for cancellation, duly endorsed, or accompanied by a proper instrument or instruments of assignment and transfer. Upon any such transfer, a new certificate or certificates of the

same tenor will be issued to the transferee. IFC may deem and treat the person in whose name this Participation Certificate is registered on the books of IFC as the absolute owner hereof for all purposes whatsoever, notwithstanding any notice to the contrary; and any payment of monies to or on the order of such person shall discharge the liability of IFC to the extent of the payment so made.

5. Payment of all sums payable by IFC hereunder will be made at................
....

This Participation Certificate shall be surrendered to IFC upon payment in full of all sums due hereunder.

THIS PARTICIPATION CERTIFICATE IS NOT AN OBLIGATION OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT OR OF ANY GOVERNMENT.

INTERNATIONAL FINANCE CORPORATION

By

Dated :

FOR VALUE RECEIVED (I) (we) hereby

sell, assign and transfer to——————

——————————————

——————————————

the within certificate issued by International Finance Corporation and hereby irrevocably authorize that Corporation to transfer such certificate on its books.

Dated ....

Witness :

....

(C) Sale of Participation Certificates Unrelated to Particular Loan Instalment and with Recourse to Selling Institution

First National City Bank's Participation Certificate Scheme

A Participation Certificate is an instrument by which First National City Bank sells to a third party, a loan they have already made to one of their customers. For example, the bank lends Rs. 7 lakhs for 90 days to one of its customers who puts up as security, say Rs. 10 lakhs of his current and moveable assets. After 30 days, the bank subsequently sells this Rs. 7 lakhs loan for the final 60 days of the 90 days term. This sale is evidence by giving a Rs. 7 lakhs Participation Certificate which is a Deed of Transfer (specimen attached), legally transferring title of the customer's Rs. 10 lakhs hypothecated current and moveable assets. More importantly, the Participation Certificate clearly indicates that the bank undertakes to repay the loan directly on maturity—the participator need look only to First National City Bank for repayment, not to the customer. Thus, legally while the participator is purchasing the obligation of one of its customers—and with it title to his pledged assets—for all practical purposes the participator is purchasing an obligation of First National City Bank itself.

For maximum flexibility, the bank will sell an entire loan, or any part thereof in units of Rs. 100,000. Also it will sell, the full remaining maturity of a loan, or only part thereof, but always in units of 30, 60 and 90 days. These terms and conditions are determined at the time of effecting the original Participation Certificate and are evidenced by two other documents copies of which are also attached.

The abovementioned transaction and the documentary mechanics have been finalised after extensive scrutiny by leading legalcounsels in the country, who are of the considered opinion that it is fully valid and legal under the Indian Laws and regulations. The Participation Certificate has been adjudicated under the local Stamp Act to attract a maximum of Rs. 15 only in stamp duty which the bank will bear.

Initially, Participation Certificates will be in minimum units of Rs. 100,000 and in three tenors :

Tenor	Rate of interest
30-day Participation	5.1/2 per cent p. a.
60-day Participation	6 per cent p. a.
90-day Participation	6.1/2 per cent p. a.

The Bank of Baroda has also introduced a Participation Certificate Scheme similar to the F.N.C.B. Scheme described above.

It may be noted that the Participation Certificate Scheme of F.N.C.B. and Bank of Baroda differ substantially from the IFC scheme described earlier. These cannot strictly be considered as a form of term loan participation. Firstly, the period of maturity of the original loan is not mentioned in the deed of transfer. The selling bank has only to ensure that at no point of time during the tenure of a participation certificate, the amount of advance to the original borrower is less than the value of the participation certificate. Through this instrument, therefore, a bank can shift parts of its cash credit or other types of advances also to others. Secondly, as the certificate is guaranteed by the selling bank, the buyer has to undertake no special risk and he is not concerned with the appraisal or the purpose of the original loan. He buys the certificate solely on the basis of the bank's guarantee. Thirdly, unlike in the IFC scheme where the rate of interest on the certificate is the same as that on the original loan, under the schemes introduced by the banks in India, the rate of interest which the certificate holder will get is fixed with reference to the maturity of the certificate and is lower than that on the original loan. Thus, although a portion of the loan and the interest thereon is transferred to the buyer, the transfer deed will also specify a certain percentage of the amount transferred to be paid as remuneration to the transferor (bank) for acting as the Collecting Agent of the transferee. This percentage is so fixed as to offer higher rates on certificates of longer maturities while leaving a margin in favour of the transferor. Fourthly, the tenure of the participation certificate is not fixed in relation to any particular instalments of the original loan. It is fixed by the selling institution obtaining along with the Deed of Transfer (transferring or selling loan) a letter from the buyer mentioning the date of repayment of the loan to him and of re-transfer of the loan by him.

The present participation certificate schemes of the banks discussed above can be treated only as variants of fixed deposit schemes.

FIRST NATIONAL CITY BANK

DEED OF TRANSFER

THIS DEED OF TRANSFER made this day of between FIRST NATIONAL CITY BANK having its Registered Office at New York and a Branch at India (hereinafter called "the Bank") of the one part and (hereinafter called "the Transferee") of the other part

WHEREAS :

(*a*) The Bank agreed to grant to (hereinafter called "the Borrower") loan facilities of

Rupees
(Rupees) carrying interest at per cent per annum under a Deed of Hypothecation dated executed by the Borrower in favour of the Bank hypothecating the goods mentioned in the schedule thereto and/or the Book Debts mentioned in the said Deed of Hypothecation as security for the repayment of the balance for the time being and from time to time due to the Bank under the said Deed :

(*b*) A principal sum of

Rupees
(Rupees) is at the date hereof due to the Bank by Borrower under the said Deed of Hypothecation

(*c*) The Bank has agreed with the Transferee to transfer to him a sum of

Rupees
(Rupees) out of the said principal sum and the interest which will hereafter accrue at the aforesaid rate on the said sum transferred together with a proportionate part of the aforesaid security as hereinafter mentioned.

NOW THIS INDENTURE WITNESSETH as follows :

1. In consideration of the sum of
Rupees
(Rupees) paid by the Transferee to the Bank (receipt of which the Bank hereby acknowledges) the Bank hereby assigns and transfers into the Transferee a sum of
Rupees
(Rupees) Being a part of the said principal sum of
Rupees
(Rupees) now due to the Bank under the said Deed of Hypothecation and all interest at the aforesaid rate on the sum transferred henceforth to become due and payable by the Borrower thereunder (hereinafter referred to as "the Debt") and the full benefit and advantage of a proportionate part of the security mentioned in the Schedule to the said Deed of Hypothecation being the same as that mentioned in the Schedule attached hereto, and/or the Book Debts mentioned in the said Deed of Hypothecation, together with the benefit of the provisions and covenants on the part of the Borrower contained in the said Deed of Hypothecation to hold the same unto the Transferee on the terms and conditions mentioned in the said Deed of Hypothecation.

2. It is agreed that the Bank shall act as the Collecting Agent of the Transferee for the collection of the Debt hereby assigned in consideration of which the Bank will be remunerated by the Transferee at the rate of per cent per annum of the amount of the sum transferred calculated from the date hereof until collection, and will also be remunerated all its expenses for the collection.

3. It is also agreed that this Assignment is on a *with recourse* basis and in the event of the Transferee exercising his right of recourse against the Bank, the Bank shall pay to the Transferee the said sum of
Rupees
(Rupees) with interest thereon at per cent per annum from the date hereof upto the date of payment and in that case the Transferee shall be bound to retransfer the said Debt and the Security, at his own expense, to the Bank on receipt of payment of the said Debt from the Bank.

IN WITNESS WHEREOF the Bank and the Transferee have set their hands hereto the day and year above written.

Signed on behalf of FIRST NATIONAL CITY BANK.	Signed on behalf of
By—————— (Bank)	By—————— (Transferee)

EXHIBIT PC 3

DRAFT OF A LETTER FROM THE TRANSFEREE TO THE BANK FIXING THE DATE OF REPAYMENT AND RETRANSFER. THE DUPLICATE OF THIS LETTER WILL BE SIGNED AND RETURNED

First National City Bank
——————Branch

Dear Sirs,

By the Deed of Transfer dated—————— between us and yourselves, you transferred to us the sum of Rs.—————————— being part of a loan made by you to Messrs.——————(the Borrower) together with interest at the rate of———per cent per annum on the sum transferred and a proportionate part of the security mentioned in the schedule to (OR a proportionate part of the Book Debts mentioned in) the Deed of Hypothecation dated—————————— executed in your favour by the Borrower.

We have agreed that notwithstanding anything contained in the abovementioned Deed of Transfer, you will repay to us on———(date) the sum of Rs.————being the sum transferred. We have also agreed that notwithstanding anything contained in the said Deed of Transfer, you shall pay us interest at the rate of——— per cent per annum on the sum transferred, calculated from the date of the Deed of Transfer until the date of repayment by you, and not at the rate of————per cent per annum as mentioned in the Deed of Transfer and in the abovementioned Deed of Hypothecation.

On receipt of repayment of the said debt as aforesaid, we shall retransfer the same to you along with the abovementioned proportionate part of the security by executing a Deed of Retransfer in your favour in the form of the specimen attached to this letter.

Please confirm.

Yours faithfully,

(TRANSFEREE)

EXHIBIT PC 4

DEED OF RE-TRANSFER

THIS DEED OF RE-TRANSFER dated this——day of——made between——(hereinafter called the "Transferer") of the one part and FIRST NATIONAL CITY BANK having its Registered Office at New York and a Branch at——, India (hereinafter called "the Bank") of the other part.

WHEREAS :

By a Deed of Hypothecation dated—— executed by——(therein and herein called "the Borrower") in favour of the Bank, the Bank agreed to give and gave the Borrower loan facilities upto a limit of Rs. —— (Rupees——) at the rate of —— per cent interest per annum on the security and on the terms and conditions mentioned therein, on the Borrower agreeing to repay to the Bank the amount due by it with interest as aforesaid.

In consideration of the sum of Rs.—— (Rupees) paid by the Transferor to the Bank, the Bank assigned and transferred to the Transferor by a Deed of Transfer dated——, a sum of Rs.—— ——(Rupees——) being part of the loan of Rs.—— (Rupees) and the full benefit and advantage of a proportionate part of the security mentioned in the schedule to the said Deed of Hypothecation being the same as those mentioned in the schedule attached hereto, and/or the Book Debts mentioned in the said Deed of Hypothecation, to hold the same unto the Transferor on the terms and conditions mentioned in the said Deed of Hypothecation ;

At the request of the Transferor the Bank has agreed to pay to the Transferor the said sum of Rs.——(Rupees) being part of the loan of Rs.——(Rupees) mentioned above and the Transferor has agreed to re-transfer to the Bank the said sum of Rs.——(Rupees) and all security mentioned in the schedule hereto attached.

NOW THIS INDENTURE WITNESSETH AS FOLLOWS :

In consideration of the sum of Rs.—— (Rupees) paid this day to the Transferor by the Bank inclusive of interest due thereon (the receipt whereof the Transferor hereby admits and acknowledges) the Transferor hereby reassigns and re-transfers unto the Bank the said sum of Rs.—— (Rupees) and all interest to become due and payable by the Borrower thereon and the full benefit and advantage of the securities mentioned in the schedule hereto attached, and/or the Book Debts mentioned in the said Deed of Hypothecation, together with the benefit of the provisions and covenants on the part of the Borrower contained in the said Deed of Hypothecation to hold the same unto the Bank on the terms and conditions mentioned in the said Deed of Hypothecation.

The Transferor hereby covenants with the Bank that it has not in any wise created any charge or lien on said sum of Rs. —— (Rupees) and interest or any part thereof and that it has full right and authority to re-transfer the said sum and interest to the Bank in the manner aforesaid.

IN WITNESS WHEREOF the Transferor and the Bank have set their hand hereto the day and year above written.

Signed on behalf of the Transferor	Signed on behalf of FIRST NATIONAL CITY BANK
By——	By——

(d) Private placement of debentures of the borrowing concerns

Under this arrangement, the lending institution would arrange to meet the requirements of the borrowing concern through a private placement of the concern's debentures. For instance, the IDBI has in some cases arranged for such placements of debentures with L.I.C. and U.T.I.

(e) Sales of portions of a balanced portfolio of loans and investments in the form of units in a closed-end Unit Trust

Under this arrangement, the lending institution can make a balanced portfolio consisting of a selected number of its loans, debentures and share investments and offer portions of this in the form of unit certificates for sale. The buyer of the unit certificate will become entitled to a *pro rata* share in the interest earnings, repayments, dividends, bonus and rights issues, etc., on the investments constituting the portfolio. But he will have no recourse to the financial institution (acting as investment trust) in case of defaults, rescheduling, etc. The closed-end trust certificate could, however, also be sold with an agreed buy-back-price. The issuing institution could agree to buy back the certificate at stipulated prices. In case there is a buy-back arrangement, the certificate becomes closely similar to a unit trust certificate.

The main difference between a closed-end type of investment trust and an ordinary unit trust is that in the case of the latter, the investor expects continuous management of the portfolio by the trust and he is not concerned with the details of the composition and changes in the portfolio. On the other hand, in the case of a closed-end investment trust of the type mentioned here, the investor does not expect any continuous management of the portfolio by the trust. His main interest is to benefit from a balanced portfolio of investments already made, the details of which are made available to him. But this type of trust suffers from certain serious handicaps. The ordinary investor who does not have the ability or inclination to undertake appraisal of the loans, debentures and equity issues forming part of the portfolio would not be able to make an independent assessment of the prospects for the investment and will not therefore be attracted to this form of investment. Secondly, he would prefer his principal to be reinvested instead of being returned to him every time a loan instalment matures or a debenture or share is sold off by the investment trust. In case the trust is precluded from selling off the debentures or shares when appropriate and has to hold the debentures till maturity (and the shares indefinitely), the buyer of the certificate cannot expect to cash in on gains. Investing individuals and institutions with specialised knowledge will also not be attracted to this form of investment as it does not offer them scope for management of the original portfolio which alone will enable them to take advantage of possibilities of making gains in a rising market and selling off at appropriate stages to avoid losses. Thirdly, unlike a unit trust or investment trust, the term lending institutions can have only narrowly diversified portfolios to offer. Their investments and loans are determined by those who approach them, by the priorities set for them, etc. They are not consciously pursuing a diversified portfolio as an investment trust does. Fourthly, the UTI and investment trust in other countries enjoy certain tax concessions. Unless a similar concession is extended to the term lending institutions in regard to the dividends and returns on their investments, buyers of units from them will have to bear the incidence of double taxation. If on the other hand what is envisaged is an outright sale of a package of shares and loans, only sophisticated institutional investors will be interested. As it is, there is already the practice of financial institutions like IDBI offering packages of its investments consisting of some good shares and some other shares, which may take more time to give returns, to institutions like the Unit Trust of India or the LIC. It must be noted that it is only institutional investors who can take a long term view and can afford to wait for a return that would be interested in such packages.

The only major advantage which this form of participation could offer is that it would enable the financial institution acting as an investment trust to exercise the rights of an equity shareholder in respect of the equities it may acquire, without locking up its own funds in the

equity. The situation could conceivably be made attractive to the investor who would be paying for the equity without exercising any of the management rights attached to the equity, if the financial institution proves to have distinct efficiency in the management of companies over which it may acquire control and in the management of its own portfolio.

ANNEXURE III

PARTICIPATION ARRANGEMENTS IN THE NATURE OF ADMINISTRATIVE COORDINATION

Participation arrangements of this nature have been entered into by some financial institutions where the amount of loan required by the borrower is large and/or where the financial risk is considered too big to be shared by a single institution. Arrangements for joint financing have also been devised to ensure a co-ordinated flow of credit to small industries on concessional terms. In joint financing arrangements one of the participating institutions may receive the loan proposal, and attend to the appraisal, documentation, sanction and recovery on behalf of all the participating institutions which would share in the loan and in the securities on an agreed basis. Details of joint financing schemes agreed to by some of the State Financial Corporations and commercial banks are set out below :

(a) Gujarat Industrial Investment Corporation Ltd. (GIIC) and United Commercial Bank (UCO)

The capital participation scheme between GIIC and UCO bank for grant of loans to industrial units provides for sharing of the amount of loan (and, consequently, the risk factor) on a 50:50 basis. The main features of the scheme are as follows :

1. All industrial units whether they are owned by a proprietor, partnership firm or a limited company wherever located in Gujarat will be eligible for financial assistance under this scheme.

2. The scheme will also be applicable to all cases where financial assistance has been sanctioned by GIIC and where disbursements have already been made by that Corporation. In order that UCO bank can scrutinise all such cases, the bank will depute their officer to scrutinise these cases and will agree to provide 50 per cent of the finance disbursed by the GIIC.

3. This scheme shall be applicable to all cases under the general scheme or the technician scheme of GIIC.

4. Under this scheme, participation will be on the basis of 50 per cent, *i.e.*, 50 per cent of the assistance sanctioned shall be provided by GIIC and 50 per cent shall be provided by the bank.

5. Application for financial assistance shall be made to GIIC or to the bank. GIIC or the bank shall forward one copy to the other institution for their information.

6. Appraisal shall be made by the GIIC. The bank shall depute a suitable officer for the purpose of appraisal if they consider it necessary.

7. If GIIC decide to sanction financial assistance on the basis of appraisal so made, they shall forward the proposal to the bank for their consideration. The bank shall thereupon communicate its decision to GIIC, and if the bank has agreed to participate, GIIC shall communicate the sanction to the concerned party.

8. As soon as the party accepts the terms and conditions, GIIC will take steps to get the legal documents prepared in accordance with the standard agreement entered into between GIIC and the bank. There shall be a *pari-passu* charge on the fixed assets of the loanee. In each case, there will be a tripartite agreement between the bank, GIIC and the loanee with a *pari-passu* charge in favour of bank and GIIC.

9. Disbursements shall be made by GIIC in accordance with the progress of the scheme.

10. GIIC will forward every month a list of all cases where the disbursements have been made during the previous month with required details. The bank will thereupon reimburse its share in all such cases to GIIC.

11. Interest from the lonee shall be charged and recovered in accordance with the terms and conditions of GIIC. The bank shall provide necessary finance according to its share on a flat rate of interest which shall be paid by GIIC every six months.

12. Arrangements for inspections and recoveries shall be made jointly by GIIC and the bank.

13. The loanee shall be advised to maintain their accounts with the bank for their working capital requirements so that the bank and the GIIC can maintain continuous watch on the loanee's accounts.

14. Period of repayment and other terms and conditions shall be in accordance with respective scheme of GIIC.

15. Losses, if any, will be borne by GIIC-bank in the ratio of amounts sanctioned and disbursed, and the quantum of such losses will be determined after taking into account :—

(*a*) the amount of the loan sanctioned and disbursed,

(*b*) the amount of interest accrued, and

(*c*) other charges required to be incurred in connection with insurance, inspection, valuation fees and such other charges, etc.

16. In case of default, recovery proceedings will be initiated by GIIC and the bank.

(b) Haryana Financial Corporation and the Bank of India

The Haryana Financial Corporation has entered into an arrangement with the Bank of Baroda and the Bank of India according to which loans for fixed assets and working capital will be granted by the Corporation and the banks respectively at a special reduced margin to small-scale industries. The reduced margin charged by the State Financial Corporation against fixed assets will provide a cushion to the industrial units towards margin money normally required by the bank for granting advances for working capital requirements. The main features of the arrangement entered into by the Corporation with the Bank of India are as follows :—

1. The State Financial Corporation will provide finance to small scale industrial units for acquiring fixed assets, *viz.* land, building, plant and machinery against the mortgage and/or hypothecation of such assets at a concessional rate of margin (to be specified in each case) and recommend such cases to the bank for providing working capital finance at a reduced rate of margin between 10 per cent to 15 per cent at the bank's discretion.

2. In respect of such cases as are recommended by the SFC, the bank will provide working capital finance with a maximum of Rs. 2 lakhs per unit by way of hypothecation/pledge of stocks and book debts at a margin not exceeding 15 per cent.

3. The bank will be free to make its own assessment of the working capital requirement and make changes in the quantum of finance as may be necessary and also be at liberty to recall the advance on its own in case of necessity. The SFC will have similar freedom to adjust its quantum of advance to a borrowing unit. However, mutual information will be passed between the bank and the SFC.

4. The bank will have second charge on the fixed assets hypothecated/mortgaged to the SFC and SFC will similarly have a second charge on the assets acquired by the unit with the working capital finance provided by the bank. SFC will insert in their documents clause giving second charge to the bank. The bank will similarly insert a suitable clause in their documents subject to legal advice. Perhaps, as between the Corporation and the bank on one side and the borrower on the other, there may be one

general form of agreement to avoid large scale changes in the existing forms of documents used at the SFC as well as the bank.

5. To facilitate early disposal of loan applications, the industrial units could be advised to put in simultaneous applications to the SFC and the bank. The application meant for the bank will be handed over by the party concerned to the nearest branch of the bank most convenient to the unit. When the application is received by the SFC, they will process the same and after sanctioning will advise the Regional Office of the bank brief particulars about the loans sanctioned by the SFC. The Regional Office of the bank will pass on this information to the branch office where working capital finance is to be made available. The branch of the bank will thereupon sanction the working capital limits and inform the SFC. The SFC will thereafter inform the branch direct when the documents at their end are executed. Similarly, the bank's branch will also inform the SFC as soon as the documents are executed by the unit in bank's favour. Alternatively, a tripartite agreement, if mutually agreed upon, could be executed.

(c) Dena Bank and Maharashtra State Financial Corporation (MSFC)

Under the arrangement, the Dena Bank has agreed to participate with the MSFC in rendering financial assistance to transport operators up to the maximum extent of Rs. 75 lakhs. The main features of the scheme are as follows :—

1. Maximum limit for an individual operator will be Rs. 5 lakhs and in the case of partnership and private limited companies it will be Rs. 10 lakhs.

2. The margin will be 25 per cent and the rate of interest for parties who make prompt payments of instalments on due dates will be at the rate of 8½ per cent and the rate of interest in all other cases will be 9 per cent.

3. The maximum period of advance will be five years.

4. The entire financing will be done by the Maharashtra State Financial Corporation and the Dena Bank on *pari passu* basis.

5. All applications in duplicate will be received by the MSFC, Bombay. If any party approaches the bank, he will be directed to the MSFC. The Corporation will forward duplicate copy of the proposal to the bank for its study. After the bank satisfies itself fully in all respects, the proposals shall be sanctioned by the bank and then put up for sanction to the MSFC.

6. All applications duly sanctioned accompanied with the documents shall be forwarded by the MSFC to the Head Office of the bank, who on receipt thereof, will make out a cheque/pay order for an amount equivalent to 50 per cent of the sanctioned limit being the bank's share of the advance to the debit of the party's account at the concerned branch in favour of either the borrower or the dealer from whom the vehicle is to be taken delivery of. The cheque/pay order will be forwarded to the MSFC which will handover the cheque/pay order together with their own share of advance either to the party or to the dealer.

7. The entire recovery work for the amount disbursed both by the MSFC as well as the bank, will be with the bank and every month a plus/minus account will be struck by the bank.

8. Interest at the rate specified is to be charged to the accounts every month and recovered along with the instalments simultaneously.

9. At the end of every month, the bank is required to make out a statement of recoveries made and due to the MSFC.

(d) Joint Financing by all India Financial Institutions

With a view to expeditious completion of legal formalities and minimising the costs of stamp duties and registration charges, the all India Institutions which participate in term loans have worked out an arrangement for the

sharing of security. Under the arrangement, the institutions have agreed to the borrower creating a joint equitable mortgage in favour of all of them which participate in a particular loan. In such cases, before creation of the joint equitable mortgage, a specific understanding is arrived at between the participating institutions and the borrower to the effect that

(*i*) one of the co-lenders usually the one which has the smallest share in the loan sanctioned will take a legal mortgage after creation of the joint equitable mortgage ;

(*ii*) one amongst the institutions interested in the equitable mortgage will accept the title deeds for itself and as agent of the others ;

(*iii*) the repayments to the holder of the legal mortgage will be scheduled in such a manner that the final instalment will be payable to the holder after the loans of all other participating institutions are paid ;

(*iv*) an *inter se* agreement will be entered into between all the participating institutions, to which the borrower will also be a party, providing, *inter alia*, that the legal mortgage and the joint equitable mortgage will rank *pari passu* for all purposes and that the title deeds deposited or to be deposited with the institution concerned shall be kept by that institution in its custody for the mutual benefit of all the participating institutions ;

(*v*) a provision will be made in the *inter se* agreement to the effect that unless otherwise agreed to in writing by all the participating institutions, the borrower shall not prepay any part of the loans granted by the participating institutions nor shall any of the participating institutions accept such prepayment without the concurrence of each of them ;

(*vi*) a further provision will be incorporated in the mortgage deed, or in the *inter se* agreement to the effect that, in the event of any default or breach of any of the conditions by the borrower in respect of any of the loans secured by the joint equitable mortgage, the moneys due to the holder of the legal mortgage shall become due and payable immediately and that it shall be entitled to enforce the security created by the legal mortgage for the benefit of all the participating institutions ;

(*vii*) the mortgage and the *inter se* agreement will be first got adjudicated by the stamp authorities to ascertain whether the same will, by reason of incorporation of the provision at (*vi*) above attract any additional stamp duty as a mortgage in relation to the loans sanctioned by the participating institutions other than the holder of the legal mortgage ;

(*viii*) in case the mortgage deed or the *inter se* agreement attracts such additional stamp duty, the facility of the equitable mortgage offered by the institutions shall be deemed to have been withdrawn.

STATEMENT I

ANNUAL FIGURES OF SAVINGS OF THE HOUSE-HOLD SECTOR IN THE FORM OF FINANCIAL ASSETS (GROSS)

(In crores of Rupees at current prices.)

	1964-65	1965-66	1966-67	1967-68	1968-69	1969-70*
I						
(i) Currency	136	287	132	164	281	300
(ii) Bank deposits	359	415	473	487	525	762
(iii) Insurance policies ..	97	98	141	150	184	184
(iv) Provident funds ..	193	198	232	292	300	364
(v) Claims on Government	108	93	83	119	80	29
(vi) Corporate and Co-operative shares & securities	47	52	48	65	83	75
	(5·0)	(4·5)	(4·3)	(5·1)	(5·7)	(4·4)
II. **Total**	**940**	**1143**	**1109**	**1277**	**1453**	**1714**
Proportion of total house-hold savings in the form of financial assets to national income at current prices (%)	4·7	5·6	4·7	4·6	5·1	5·5

Figures in brackets show percentage of item (vi) to total savings in the form of Financial Assets (II)

Note : (1) Bank deposits includes deposits of public with non-banking companies.
(2) In the case of Insurance policies, State Government Insurance Funds have been included and adjustment has been made for deposits, premiums and supplementary contracts pending payment.
(3) Investments in units of the Unit Trust of India are included in item (vi).
(4) Claims on Government includes Government securities and small savings.

* Provisional

STATEMENT II

MATURITY CLASSIFICATION OF FIXED DEPOSITS WITH SCHEDULED COMMERCIAL BANKS, AS AT THE END OF MARCH 1969

(Amount in crores of rupees)

Period of maturity	Amount	% to total
1. 6 months or less	456·0	20·2
2. More than 6 months but up to 1 year ..	882·1	39·1
3. More than 1 year but upto 2 years ..	197·6	8·8
4. More than 2 years but up to 3 years	118·5	5·3
5. More than 3 years but up to 5 years	461·2	20·4
6. Above 5 years	139·9	6·2
TOTAL	2255·3	100·0

STATEMENT III

COMPOSITION OF DEPOSITS OF COMMERCIAL BANKS IN SELECTED COUNTRIES

Sr. No.	Name of the country	Current Deposits	Time Deposits	Personal Savings	Total
1.	U.S.A.				
	Commercial Banks	225,730*	220,570**	—	446,300
	(September 30, 1970)	(50·6)	(49·4)		
	($ Million)				
2.	UNITED KINGDOM				
	London Clearing Banks	5,431	4,846	—	10,277
	(August 19, 1970)	(52·9)	(47·1)		
	(£ Million)				
3.	CANADA				
	Chartered Banks	5,880	4,611 @@	16,533	27,024@
	(end November 1970)	(21·8)	(17·1)	(61·2)	
	($ Million)				
4.	AUSTRALIA				
	Major Trading Banks	3,700·3+	2,780·6+	—	6,480·9
	(end August 1970)	(57·1)	(42·9)		
	($ Million)				
5.	INDIA				
	Scheduled Commercial Banks (March 31, 1969)	1,149·3	2,255·3	1,111·5++	4,516·1
	(Rs. crores)	(25·5)	(49·9)	(24·6)	

Note : Figures in brackets show percentages to total.
* Includes inter-bank and U. S. Government Deposits.
** Includes inter-bank deposits.
@@ Covers only non-personal term and notice deposits.
@ Excludes Government of Canada Deposits.
\+ Includes other banks' deposits.
\+\+ Savings accounts.

STATEMENT IV

SOURCES OF FUNDS OF CORPORATE SECTOR IN VARIOUS COUNTRIES

Sources of funds	INDIA (in million Rs.) 1961-62	INDIA (in million Rs.) 1966-67	INDIA (in million Rs.) 1967-68	United Kingdom 1968 (in millions £)	United States 1968 (in billion $)	Australia 1967-68 (in million $)
I. Internal sources (retained profits and depreciation, etc.)	1811·2	2571·0	2145·2	2899·5	80·8	1558·0
	(55·1)	(40·9)	(40·2)	(63·4)	(58·8)	(57·1)
II. External sources—	1473·7	3708·8	3184·0	1673·6	56·7	1169·7
of which—	(44·9)	(59·1)	(59·8)	(36·6)	(41·2)	(42·9)
(*i*) Capital raised from market including debentures	406·8	616·6*	531·1*	750·9	12·1	393·6
	(12·4)	(9·8)	(10·0)	(16·4)	(8·8)	(14·4)
(*ii*) Bank borrowings (short-term credit)	525·7@	1281·8	1293·7	125·2	10·6	67·0
	(16·0)	(20·4)	(24·3)	(2·7)	(7·7)	(2·5)
(*iii*) Long-term credit (from financial institutions)	127·2**	470·5**	322·9**	404·7	16·4	132·7
	(3·9)	(7·5)	(6·1)	(8·9)	(11·9)	(4·9)
(*iv*) Others (including trade credit, etc.)	414·0	1340·0	1036·3	392·8	17·6	576·4
	(12·6)	(21·4)	(19·4)	(8·6)	(12·8)	(21·1)
TOTAL (I+II)	**3284·9**	**6279·9**	**5329·2**	**4573·1**	**137·5**	**2727·7**
	(100·0)	**(100·0)**	**(100·0)**	**(100·0)**	**(100·0)**	**(100·0)**

Figures in brackets show percentages to total
* Includes deposits from public.
@ Includes term-loans from banks.
** Includes borrowings from Government.

SOURCES :
INDIA —Reserve Bank of India Bulletin—December 1967 & October 1970.
U K. —Financial Statistics—Central Statistical Office—October 1970
U. S. —Federal Reserve Bulletin—November 1969.
AUSTRALIA—Reserve Bank of Australia Statistical Bulletin—July 1970.

STATEMENT V.

RESOURCES OF TERM LENDING INSTITUTIONS IN INDIA

Combined Resources of Term Lending Institutions (IDBI, ICICI, IFCI and SFCs)

As on June 30, 1970 (Crores of rupees)

1.	Paid up capital	51·15
2.	Reserves	36·12
3.	Borrowings from :	
	(a) Central Govt./State Govt.	291·01*
	(b) Reserve Bank of India	28·83
	(c) The market by issue of bonds & debentures	118·75
4.	Foreign credits	85·56
5.	Deposits	13·36
	Total resources	**624·78**
	Total resources (excluding foreign credits)	**539·22**
	Of which :	
1.	Share capital from	
	(a) State Governments	10·47
	(b) Reserve Bank of India	22·44
2.	Bonds or debentures	
	(a) Reserve Bank of India	0·37
3.	Borrowings from :	
	(a) Central/State Governments	291·01*
	(b) Reserve Bank of India	28·83
	Total 1+2+3	**353·12**
	% of (1+2+3) to total resources	*57*
	% of (1+2+3) to total resources excluding foreign credits	*66*

* Includes loan of Rs. 27·35 crores from the Central Government for the Development Assistance Fund maintained by the IDBI.

STATEMENT VI

INSTITUTION-WISE DETAILS OF RESOURCES

1. INDUSTRIAL FINANCE CORPORATION OF INDIA AS ON JUNE 30, 1970

	(Rupees in crores)
Total Resources:—(excluding foreign credits) (Comprises Share Capital, Reserves, Borrowings, Deposits and Bonds & Debentures)	**153·35**
Of which :	
(a) *Share Capital*	
From IDBI	4·17
(b) *Bonds*—IDBI, RBI and Government contribution	Nil
(c) *Borrowings*	
Government	79·61
IDBI	—
RBI	—
	79·61
Total (a+b+c) :	**83·78**
Percentage of (a+b+c) to total resources	*55*

2. INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA LTD. AS ON AUGUST 31, 1970.

	(Rupees in crores)
Total Resources: (excluding foreign credits) (Comprises Share Capital, Reserves, Borrowings, Deposits and Bonds & Debentures).	**68·57**
Of which :	
(a) *Share Capital*	
No subscription from Government, RBI or IDBI.	
(b) *Debentures*	
IDBI contribution	13·91
(c) *Borrowings*	
Government	31·60
IDBI	12·30
RBI	—
	43·90
Total (a+b+c)	**57·81**
Percentage of (a+b+c) to total resources	*84*

3. STATE FINANCIAL CORPORATIONS AS ON MARCH 31, 1970

	(Rupees in crores).
Total Resources: (Comprises Share Capital, Reserves, Borrowings, Deposits and Bonds & Debentures).	**126·90**
Of which :	
(a) *Share capital*	
State Government	10·47
IDBI	1·18
RBI	2·44
	14·09
(b) *Bonds*	
R.B.I. and I.D.B.I. contribution	5·33
(c) *Borrowings*	
State Government	3·01
I.D.B.I.	22·44
R.B.I.	2·56
	28·01
Total (a+b+c)	**47·43**
Percentage of (a+b+c) to total resources	*37*

STATEMENT VII

CHANGE IN RESOURCES OF TERM LENDING INSTITUTIONS BETWEEN 1965 and 1970

(Amount in crores of rupees)

Institution	Resources		Contribution of Government, R. B. I and I.D.B.I.	*Percentage of*	
	Total	Excluding foreign currency loans		*Col.* (4) *to* *Col.* (2)	*Col.* (4) *to* *Col.* (3)
(1)	(2)	(3)	(4)	(5)	(6)
1. Industrial Finance Corporation of India					
June 1965	93·04	87·13	45·11	*48*	*52*
June 1970	175·04	153·35	83·78	*48*	*55*
2. Industrial Credit and Investment Corporation of India Ltd.					
December 1965 ..	66·86	38·94	29·50	*44*	*76*
August 1970	132·44	68·57	57·81	*43*	*84*
3. State Financial Corporations					
March 1963	44·80	—	12·69	*28*	—
March 1970 ..	126·90	—	47·43	*37*	—

STATEMET VIII

COMPARATIVE SHORT AND LONG TERM LENDING RATES OF COMMERCIAL BANKS AND SPECIALISED INSTITUTIONS IN SELECTED COUNTRIES

(Per cent per annum)

Name of the country	Prime short term rate of interest by banks	3 to 5 year Bank Term Loan rates	Long term rates of specialised financial institutions
1. U.S.A.	8	8 to 11	N.A.
2. U. K.	8	9	8½ to 9@
3. Canada ..	8	Not quoted	10
4. Japan	6·25@@	Not quoted	8·2*
5. Australia ..	7·50**	8·25	Basic : 6·50 Maximum : 7·50
6. India	9	9½	7 to 9

@ It is learnt that the rate of interest charged by the Finance Corporation for Industry Ltd., is higher by 1½ to 2% than the inter bank rate.

@@ Loan rates secured by bonds and debentures specially designated by the Bank of Japan.

* Japan Development Bank's standard rate.

** Maximum overdraft rate of Australian Banks—(From : Reserve Bank of Australia, Monthly Bulletin).

SOURCES : Monthly Economic Report — First National City Bank—July 1970; data furnished in this report relates to rates prevalent in (1) United States and Canada as on July 10, 1970 and (2) Europe and other countries as on June 30, 1970.

CANADA : Industrial Development Bank, Canada, Annual Report, 1969.

AUSTRALIA : Commonwealth Banking Corporation, Annual Report, 1969.

STATEMENT IX

BILLS REDISCOUNTING SCHEME — COST OF FINANCE TO THE PURCHASER

Unexpired usance of bills/promissory notes	Rediscount rates charged by IDBI to a discounting bank	Maximum discount rates charged by the discounting bank to his customer viz. the seller of machinery	Unexpired usance of bills/promissory notes	Incidence of rediscount rates of IDBI in terms of simple interest viz. the average* cost of refinance to the discounting bank in terms of simple interest	Incidence of maximum discount rates of the discounting bank in terms of simple interest viz. the average* cost of credit to the purchaser in terms of simple interest (exclusive of guarantee commission and stamp duty)	Average* effective cost of credit to the purchaser (in terms of simple interest) including guarantee commission/acceptance charges@ and stamp duty†
	%p.a.	%p.a.		%p.a.	%p.a.	%p.a.
6 months to 36 months ..	6·00	7·00	6 to 36 months	6·91	8·28	9·83
Over 36 months to 60 months	5·50	6·50	6 to 60 months	7·11	8·76	10·33
Over 60 months to 84 months ..	5·00	6·00	6 to 84 months	7·20	9·20	10·85

* The average cost has been worked out assuming that deferred instalments are payable half-yearly and discounted value of each instalment is Rs. 1,000. If all the bills in a set have usance of over 12 months, the average cost will go up.

@ Acceptance/guarnatee commission is charged in advance and the usual rate for this is 1% p.a.

† Stamp duty rates are : (*i*) Bills with usance upto 9 months—Rs. 1·50 for every Rs. 1000 or part thereof

(*ii*) Bills with usance upto 12 months—Rs. 2·00 for every Rs. 1000 or part thereof

(*iii*) Bills with usance beyond 12 months—Rs. 4·00 for every Rs. 1000 or part thereof.